

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:)
) File No. A-03907-A
CAPWEALTH ADVISORS, LLC)

WITNESS: Timothy Pagliara

PAGES: 1 through 163

PLACE: Securities and Exchange Commission
 950 East Paces Ferry, NE
 Suite 900
 Atlanta, Georgia 30326

DATE: Friday, May 1, 2020

The above-entitled matter came on for hearing via
WebEx, pursuant to notice, at 9:35 a.m.

Diversified Reporting Services, Inc.

(202) 467-9200

1 APPEARANCES:

2

3 On behalf of the Securities and Exchange Commission:

4 BRIAN BASINGER, ESQ.

5 STEPHEN E. DONAHUE, ASSISTANT REGIONAL DIRECTOR

6 KRISTIN MURNAHAN, ESQ.

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C O N T E N T S

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WITNESS:

EXAMINATION

Timothy Pagliara

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EXHIBITS:

DESCRIPTION

IDENTIFIED

CAP-20 March 11, 2020 subpoena

4

CAP-21 Background Questionnaire

4

CAP-22 Form ADV Part II B Brochure

4

Supplement for Timothy J. Pagliara

CAP-23 Form ADV Uniform Application for

4

Investment Adviser Registration

CAP-24 February 12, 2018 press release

4

1 P R O C E E D I N G S

2 (SEC Exhibit Nos. CAP-20
3 through CAP-24 were marked for
4 identification.)

5 MR. BASINGER: So, we are on the record
6 at 9:35 a.m. on Friday, May the 1st of 2020.

7 For the record, today's testimony is
8 being conducted remotely via WebEx in light of the
9 Coronavirus Pandemic.

10 Mr. Pagliara, do you consent to me
11 swearing you in now remotely?

12 MR. PAGLIARA: Yes, I do.

13 MR. BASINGER: Would you please raise
14 your right hand.

15 Do you swear to tell the truth, the
16 whole truth and nothing but the truth?

17 MR. PAGLIARA: I do.

18 Whereupon,

19 TIMOTHY PAGLIARA
20 was called as a witness and, having been first
21 duly sworn, was examined and testified as follows:

22 EXAMINATION

23 BY MR. BASINGER:

24 Q You may put your hand down. Thank you.

25 Please state and spell your name for the

1 record, including your middle name.

2 A Timothy Jude Pagliara. Last name is
3 spelt P-A-G-L-I-A-R-A.

4 Q And is the middle name J-U-D-E?

5 A Yes, sir.

6 Q Please state your date of birth.

7 A [REDACTED].

8 Q Please state and spell your home address
9 where you are -- your primary residence I should
10 say.

11 A [REDACTED],
12 [REDACTED], Franklin, Tennessee,
13 37067.

14 Q And for the record, are you at that
15 location today for testimony?

16 A No, I am not.

17 Q Where are you present today?

18 A I am at [REDACTED]
19 [REDACTED].

20 Q Thank you. Is that another residence of
21 yours?

22 A Yes.

23 Q Is it a vacation home?

24 A It's a second home.

25 Q Okay, thank you.

1 My name is Brian Basinger and I'm an
2 Officer of the Commission for the purpose of
3 today's proceeding. Also joining us today via
4 WebEx are Stephen Donahue and Kristin Murnahan who
5 also are officers for the purpose of today's
6 proceeding.

7 This is an investigation by the United
8 States Securities and Exchange Commission In The
9 Matter of CapWealth Advisors, LLC, Case Number
10 A-3907, to determine whether there have been
11 violations of certain provisions of the Federal
12 Securities Laws. The facts developed in this
13 investigation -- investigation, however, might
14 constitute violations of other federal or state,
15 civil or criminal laws.

16 For the record today we are using WebEx
17 technology to hear and see -- hear and see each
18 other. I will be displaying exhibits during the
19 course of the testimony today using the WebEx
20 technology by sharing Adobe Acrobat from my laptop
21 computer.

22 Now, what we're going to do at this
23 point, Mr. Pagliara, is I'm going to open a
24 different document. I do have Exhibit 1 already
25 open which is the SEC Form 1662. And we'll talk

1 about that in a few minutes, but the first thing I
2 want to show you is what's known as the Formal
3 Order of Investigation in this matter. This is
4 not something that you've seen before. It's a non
5 public order issued by the Commission. And what
6 I'm going to do is I'm going to scroll down and
7 give you time to look at it, but before I do much
8 with the scrolling, just to explain to you, this
9 is the Formal Order that the staff obtained from
10 the Securities and Exchange Commission that
11 empowers us to conduct our investigation.

12 What it does is it identifies the name
13 of the investigation, it identifies CapWealth
14 Advisors, LLC and it also names Steve Donahue,
15 Kristin Murnahan and myself, along with others at
16 the SEC, as officers for the purpose of the
17 investigation, including the ability to issue
18 subpoenas and take testimony.

19 So, I'm going to scroll down to let you
20 look at it. And you let me know when you're ready
21 for me to keep scrolling. It's about two pages
22 long. So, take your time and let me know when you
23 want me to scroll further down.

24 A You can scroll down further.

25 (The witness examined the document.)

1 A You can scroll down.

2 Q I'm going to go to the second page now;
3 is that okay?

4 A Yes.

5 (The witness examined the document.)

6 A Who is Dabney O'Riordan? That's another
7 person identified.

8 Q Yeah. Catherine Dabney O'Riordan and
9 Adam Anderson are the two co-chiefs of the Asset
10 Management Units for the SEC's Division of
11 Enforcement. They're not on the call today.
12 Justin Jeffries is the Associate Director of
13 Enforcement for the Atlanta Regional Office where
14 Kristin, Steve and I are based.

15 John Farinacci and Daniel Pine are two
16 of the subject matter experts that work in the
17 Asset Management Unit, but neither of them is on
18 the call today either, but these are all
19 individuals, including Steve and myself, who are
20 on this Formal Order that are named as officers
21 for the purpose of the investigation. If I scroll
22 down, you'll see that includes the empowerment to
23 administer oaths, subpoena witnesses, take
24 testimony, etc.

25 A Thanks. You can go to the next page.

1 Q Okay. This is the bottom of the first
2 page. What I'm going to do now is I'm just going
3 to show you there's a Supplemental Formal Order
4 I'm going to open. What that does is it also
5 names some additional staff to the investigation
6 and I'm going to scroll down. This is it right
7 here. It added Graham Loomis and Kristin Murnahan.
8 Kristin is a senior trial counsel in the Atlanta
9 office who is on the line today. And then, Graham
10 Loomis, who is also named as her supervisor, who
11 is the regional trial counsel for the Atlanta
12 office.

13 A Thank you.

14 Q Do you have -- have you had an
15 opportunity now to review the Formal Order and the
16 Supplemental Formal Order?

17 A Yes.

18 Q Do you have any questions about those
19 documents?

20 A No.

21 Q I'm going to close them now, but if you
22 have any questions about them or would like to see
23 them again during the testimony today you're
24 welcome to ask to see them again.

25 A Thank you.

1 Q Mr. Pagliara, are you represented by --
2 oh, actually, let me back up. Let's go over
3 Exhibit 1 here.

4 So, now I'm displaying Exhibit No. 1.
5 And for the purpose of today, exhibits we're going
6 to show, as a shorthand we're using -- we're
7 calling them CapWealth exhibits. So, I'm using a
8 shorthand as C-A-P followed by the exhibit number.
9 So, you'll see Exhibit 1, CAP-1, has already been
10 marked. And this is the Form 1662 of the SEC. It
11 was previously sent to you via an attachment to
12 your subpoena testimony -- testimony subpoena, as
13 well as, the document subpoenas that have been
14 sent out before in the case.

15 Have you had a chance to look over
16 Exhibit No. 1 before, the 1662?

17 A Yes.

18 Q Do you have any questions about Exhibit
19 No. 1?

20 A No.

21 Q Okay, thank you.

22 Mr. Pagliara, are you represented by
23 counsel today?

24 A Yes.

25 MR. BASINGER: Would counsel please

1 identify himself for the record, including his
2 name and his firm's name.

3 MR. BULSO: Good morning, Brian. This is
4 Gino Bulso, B-U-L-S-O, with Leader, Bulso and
5 Nolan, PLC in Nashville, Tennessee.

6 MR. BASINGER: And, Mr. Bulso, are you
7 representing Mr. Pagliara as his counsel today?

8 MR. BULSO: We are, yes.

9 Q Mr. Pagliara, do you understand that Mr.
10 Bulso and his firm are also representing CapWealth
11 Advisors, as well as, Phoebe Venable and maybe
12 others in this investigation?

13 A Yes.

14 Q And are you comfortable proceeding with
15 today's testimony knowing that?

16 A Yes.

17 Q I'm going to now display via my screen
18 what has been marked as CAP Exhibit No. 20, which
19 is a subpoena issued on March 11th, 2020 to
20 Timothy Pagliara. You'll note this was originally
21 calling for testimony to take place on April 3rd,
22 2020, but in light of the pandemic we agreed to
23 postpone by four weeks the testimony date until
24 today, May 1st, 2020.

25 Mr. Pagliara, have you seen this

1 document before?

2 A Yes.

3 Q What I'm going to do is I'm just going
4 to click through it. You'll see there's the
5 second page that has my signature on it, on the --
6 the letter. And then on the next page is the
7 original subpoena. And then, after that is a copy
8 of the 1662 which we just saw as Exhibit No. 1.

9 And then there is an e-mail after that
10 between me and Mr. Bulso on April 13 of 2020 in
11 which Mr. Bulso confirms that we were agreeing to
12 reschedule today's testimony until May 1st for
13 you.

14 Is this the subpoena, as modified by the
15 e-mail exchange, pursuant to which you are
16 appearing here today, Mr. Pagliara?

17 A Yes.

18 Q Do you have any questions about it?

19 A No.

20 Q Okay. I'm going to go ahead and close
21 Exhibit 20.

22 I'm going to go over a few preliminary
23 matters today. Mr. Pagliara, you are under oath
24 here today and you should make every effort to
25 give the best, most complete and honest answers to

1 our questions today. Mr. Pagliara, do you
2 understand this?

3 A Yes.

4 Q Would it be possible for you to adjust
5 your camera view so we could see you a little bit
6 better because right now all we can see is the top
7 of your hat.

8 A How is that?

9 Q That's a little better. Thank you. Just
10 because all we could see before was your hat. So,
11 to the extent when giving answers you can look up
12 a little so we can see you that will be helpful.

13 A I hope you guys aren't Braves fans. This
14 could be very painful.

15 Q I understand. I'll note for the record
16 you're wearing a baseball CAP -- is that for the
17 Cardinals? I'm trying to see.

18 A Yes, sir.

19 Q The St. Louis Cardinals, okay.

20 A Yes.

21 Q Just to back up. Mr. Pagliara, you do
22 understand that you're under oath today and you
23 should make every effort to give honest, complete
24 answers, correct?

25 A Yes.

1 Q Mr. Pagliara, is there any reason you
2 are unable to give accurate testimony today?

3 A No.

4 Q If you do not understand a question
5 today, please let us know and we can try to
6 rephrase it.

7 If you don't understand a question, will
8 you let us know?

9 A Yes.

10 Q If you need to take a break for any
11 reason, please let us know and we can consider
12 instructing the court reporter to go off the
13 record. As long as there's not a question pending
14 that should not be a problem, but we may want to
15 try to finish the question and answer session that
16 we're on at that time before taking a break. The
17 court reporter will only go off the record at the
18 request of the SEC.

19 Mr. Pagliara, if you need a break today
20 will you let us know?

21 A Yes.

22 Q When responding during testimony today
23 for the benefit of the court reporter, please make
24 sure to give verbal answers as opposed to nodding
25 or shaking your head. It's okay if you do

1 initially do that, but we may jump in and tell
2 you, pardon us, but you're -- you're shaking your
3 head. It looks like you're trying to answer. Can
4 you give us a verbal response. Sometimes people
5 do that and they don't realize they're not saying
6 a verbal reply.

7 We also urge you to try to say yes or no
8 as responses as opposed to uh-huh or hu-huh
9 because sometimes those types of responses can be
10 hard to decipher. And we want to make sure for
11 your benefit and ours, there's a clean, clear
12 record. Does that make sense?

13 A Yes.

14 Q And we'll try not to talk over each
15 other today. So, we'll ask you to try to let us
16 make sure we get our question out before you start
17 answering. You might see me hold my hands up like
18 this if I feel you're starting to interject before
19 I've finished my question just to make sure you
20 understand I'm still trying to get the question
21 out before I want you to start trying to answer.

22 Because testimony is occurring remotely,
23 we're not all in the same room today. However,
24 this testimony does remain a confidential, non
25 public event. No other individual should be

1 participating or observing today's testimony other
2 than the SEC staff, the court reporter, the
3 witness and witness counsel.

4 Mr. Pagliara, are you alone in the room
5 from which you are participating today?

6 A Yes.

7 Q Is anybody else nearby who is listening?

8 A No.

9 Q Mr. Pagliara, do you promise that during
10 today's testimony you will refrain from making any
11 recordings of the testimony?

12 A Yes.

13 Q And do you promise you will refrain
14 today from taking any screen shots of the screen
15 that we are using?

16 A Why would I? If you're showing me an
17 exhibit -- I guess, no, I've already got the
18 exhibit. So, no. I -- yes, I will refrain from
19 doing that. I don't know that I would do it
20 anyway, but --

21 Q Understood.

22 MR. BASINGER: Mr. Bulso, are you making
23 any audio or video recording of today's testimony?

24 MR. BULSO: Brian, this is Gino. There's
25 nobody here. I'm not making any screen shots.

1 I've got no plans to do that. We're not recording
2 anything. We're proceeding today the same way we
3 did yesterday.

4 MR. BASINGER: Thank you.

5 Q During the course of the proceeding
6 today we're going to ask you, Mr. Pagliara,
7 questions about things that happened or may have
8 happened in the past. Obviously time has gone by
9 since those events and you may have a better
10 recollection of some events than others. We do
11 want to hear about all of your recollections today
12 though. So, if some thing is 100 percent certain,
13 feel free to make that clear to us that you
14 remember something clearly. And if something is
15 less clear and you have a hazy recollection, feel
16 free to make clear that the recollection is hazy
17 or less than certain. Does that make sense?

18 A Yes.

19 Q I also want to make clear for the
20 record, and I'll repeat this today if needed,
21 we're not asking for information from you that's
22 protected by the attorney-client privilege or
23 attorney work product doctrine. Do you understand
24 this?

25 A Yes.

1 Q Do you have any questions for us about
2 these preliminary matters?

3 A No.

4 Q Apart from communicating with Mr. Bulso
5 as your counsel, have you told anybody else about
6 the fact that you received a testimony subpoena
7 from the SEC in this investigation?

8 A Yes.

9 Q Who else have you told?

10 A People on my staff.

11 Q Can you name anybody specifically that
12 you have told?

13 A Phoebe Venable, Ryan Hitt, Allen Boland,
14 Traci Olive, those -- Stacy Yancy.

15 Q What was the last name again?

16 A Yancy, Y-A-N-C-Y. They have all been
17 involved in gathering material related to the
18 subpoena and the investigation.

19 Q And I'm just asking you to repeat the
20 name of the last person just because I couldn't
21 hear it very well, the full name.

22 A Stacy Yancy, Y-A-N-C-Y.

23 Q And is Stacy spelled with a C-Y, a C-I
24 or something else?

25 A C-Y.

1 Q Okay. So, S-T-A-C-Y?

2 A Yes.

3 Q Did any of those individuals help you
4 prepare to give testimony today?

5 A No.

6 Q I'm going to now display Exhibit 21
7 which is a background questionnaire. You may --
8 do you have paper copies of some of the exhibits
9 in front of you, Mr. Pagliara?

10 A No.

11 Q Okay. So, we're going to be showing you
12 today everything via the screen; is that correct?

13 A Yes.

14 Q Okay. Can you see Exhibit 21 at this
15 point?

16 A Yes.

17 Q Okay. I'm going to -- you'll see it's
18 marked at the bottom already as CAP Exhibit 21.
19 I'm going to zoom in a little make it a little bit
20 bigger.

21 Can you identify what Exhibit 21 is?

22 A The background questionnaire that I've
23 prepared prior to this deposition.

24 Q And are its contents accurate?

25 A Yes.

1 Q Okay. We're going to go over some of
2 the portions of it now verbally. So, it's going
3 to be a little bit redundant since you've already
4 filled this out, but I'm going to advance to the
5 page where your educational background is
6 contained, but if you could go ahead and start
7 with anything after high school telling us about
8 your educational background in terms of degrees
9 you've received, where you've studied starting
10 from furthest back in history to the most current.

11 A Can you repeat that question?

12 Q Sure. If you could just tell us your
13 education background in sequential order.

14 A In sequential order starting from high
15 school to the present?

16 Q No, you can skip high school. You can
17 skip high school. You can start after high
18 school?

19 A I have an undergraduate degree in
20 philosophy from St. Louis University and a law
21 degree from St. Louis University and attended
22 various different institutes as part of my
23 training in the industry.

24 Q And have you ever practiced as an
25 attorney?

1 A I've done expert witness testimony and
2 some minor things back in early part of my career.

3 Q After you graduated from law school did
4 you sit for a bar exam?

5 A Yes.

6 Q And did you pass?

7 A Yes.

8 Q Have you been sworn in to any state bars
9 before?

10 A Yes.

11 Q Which ones?

12 A In Tennessee. I'm a member of the
13 Tennessee Bar Association.

14 Q You're currently an active member?

15 A Actively inactive. I don't practice
16 law, but I have that designation.

17 Q So, are you a dues paying member who has
18 an inactive status?

19 A That's how I'd characterize it, yes.

20 Q Okay. So, you do not currently practice
21 law for any clients, correct?

22 A That's correct.

23 Q Okay. Do you have any other
24 professional licenses besides your attorneys
25 license?

1 A No.

2 Q Let me rephrase maybe.

3 Do you have any securities related
4 designations or licenses?

5 A I've got -- the only designation I still
6 have is Series 65. I have no FINRA licenses.
7 Those were all terminated when we closed our
8 broker-dealer. There may be one or two other
9 supervisory designations with the SEC. I don't
10 believe so.

11 Q Do you think your FINRA Series 65 is
12 still active?

13 A No.

14 Q But you think -- you know you've held 65
15 in the past?

16 A I did, yes.

17 Q Okay. And just for the record, when you
18 say FINRA, you're talking about the Financial
19 Industry Regulatory Authority?

20 A Yes.

21 Q Okay. I'll try to spell out acronyms
22 today if you or I or anyone else uses them without
23 first introducing what they stand for.

24 Now, I'd like to just talk about your
25 employment history. What is your -- I'll advance

1 to that section of the document, but if you could
2 tell us, after you left law school what was your
3 first job after law school?

4 A I was actually employed while I was in
5 law school and that employment extended to after I
6 graduated from law school. It's Edward Jones and
7 Company, St. Louis, Missouri.

8 Q What was your initial position at Edward
9 Jones when you started there?

10 A I was an intern. I wrote the Series 7
11 training program that they used for licensing
12 their representatives.

13 Q And so that was the training program
14 used for new representatives that were being
15 trained to join Edward Jones?

16 A Yeah, that were taking Series 7.

17 Q What -- what specifically were the types
18 of training materials you were preparing?

19 A It was all the preparation for the
20 Series 7 examination.

21 Q So, they were examination preparation
22 materials?

23 A Yes, sir.

24 Q What else did you do in that position
25 when you were there?

1 A After I completed my assignment with
2 preparing the Series 7 program I was part of a
3 team with a -- a partner that created their
4 financial planning department.

5 Q And was that the full scope of what you
6 did in that role?

7 A Yes. And I had various different
8 assignments that they would give me everything
9 from evaluating leases on buildings that they were
10 acquiring to working with representatives and
11 helping them establish goals and objectives for
12 their clients.

13 Q I was going to ask just a quick
14 technological question. On your view on your
15 screen are the video feeds of us at the top or the
16 bottom?

17 A At the very top.

18 Q Okay. I just wanted to make sure
19 they're towards the top. I found for everybody
20 it's easier for us to see folks if they're looking
21 at the video if it's up toward the top of the
22 screen and closer towards the cameras.

23 A No. My view right now is right on your
24 document.

25 Q Okay. So, if you could tell us what --

1 did you hold any other positions while you were at
2 Edward Jones?

3 A I took Series 7 and actually started
4 working with clients as well while I was there.

5 Q So, maybe what would help me is to back
6 up a little and talk about the chronology.

7 If I direct your attention to Exhibit 21
8 and I go back a couple of pages, I think we saw
9 that you were in law school from '79 to '83 and I
10 just wondered, when we go back to the Edward Jones
11 job description, it lists the position of limited
12 partner from 1980 to '89, but did you start
13 working there in your initial role working on
14 preparing the Series 7 exam prep materials earlier
15 than 1980?

16 A No. No. It was in my second year of
17 law school. I was going to join the MBA program.

18 Q So, limited partner was -- was limited
19 partner a position that you later had after you
20 joined?

21 A That was the last title that I held
22 before I left the firm in 1989.

23 Q Okay. I just wanted to clarify when you
24 held that position, okay.

25 So, when do you -- what year do you

1 think you started actually seeing clients while
2 you were at Edward Jones?

3 A After I passed the Series 7. I think it
4 may have been in early 1981.

5 Q And tell us about the types of clients
6 that you served in that role?

7 A Mainly retirees, people working on
8 pensions -- with pensions. It was part of, you
9 know, the process of Edward Jones to understand
10 those clients.

11 Q At that time period around 1981 do you
12 recall approximately in terms of a ballpark range
13 how many clients you were serving directly?

14 A No, I don't. It was under -- under
15 five.

16 Q Did that grow over time?

17 A Yes.

18 Q Tell us about how your client base grew
19 over time at Edward Jones.

20 A Well, I left the home office in 1982 and
21 moved to Franklin, Tennessee to open the Franklin,
22 Tennessee office of Edward Jones.

23 Q Were you the initial staff member to do
24 that?

25 A Yes.

1 Q Did anybody else go with you?

2 A No.

3 Q How long did you work in that position
4 in Franklin, Tennessee as the sole person in the
5 office?

6 A In 1982 to -- or 1983 'til 1989.

7 Q So, you were the only registered
8 representative working in that office during that
9 time period?

10 A Yes.

11 Q Did you have any support staff working
12 with you in the office physically?

13 A About six months after I established the
14 office I did, yes.

15 Q Okay. But were there ever any other
16 advisory representatives that came and worked out
17 of that office with you?

18 A No.

19 Q At that point once you were in that
20 office is that when you had the title of limited
21 partner?

22 A I became a limited partner I believe in
23 either 1986 or 1987.

24 Q Okay. And did that change, the -- the
25 nature of your job, once you became a limited

1 partner in terms of your responsibilities and your
2 role at Edward Jones?

3 A No. It was an acknowledgment of some of
4 the responsibilities that they gave me. I was
5 involved -- continued my involvement in the
6 training process and actually, you know, hired
7 representatives for them.

8 Q Did you continue to serve mostly retiree
9 clients?

10 A Yes.

11 Q What types of -- I guess, what were
12 the -- as far as you recall, the clients you
13 served at that time period, what were their usual
14 investment objectives?

15 A It was -- you know, they were equity
16 income. They needed growth and income. Some of
17 them needed some growth. It was a broad range of
18 objectives. Every client was different.

19 Q In serving your Edward Jones clients,
20 how did you generally make investment decisions
21 for them?

22 A Based upon the feedback that they gave
23 me about what their goals and objectives were and
24 uniqueness of their situation.

25 Q Were most of those clients in

1 discretionary accounts?

2 A No. There were no discretionary
3 accounts in that -- during that time period.

4 Q Well, let me actually back up and ask
5 you a couple of questions.

6 Were you serving as both an advisory
7 representative to these clients as well as a
8 registered representative?

9 A No. No. It was not an advisory
10 relationship. It was purely brokerage.

11 Q Okay. I should have asked that first, I
12 apologize.

13 So, this was -- your time period through
14 1989 at Edward Jones is purely brokerage
15 customers?

16 A Yes.

17 Q Okay. And why did you leave Edward --

18 A Exclusively brokerage.

19 Q Why did you leave Edward Jones?

20 A I was working with higher net worth
21 clients than what they were typically comfortable
22 with working on and I had a -- a great business
23 opportunity to join Hilliard Lyons.

24 Q And where was that? Was that also
25 joining them by staying in Franklin?

1 A Both Franklin and Nashville. The firm
2 was headquartered in Louisville, Kentucky.

3 MR. BASINGER: I'll note for the record,
4 I've advanced Exhibit 21 to page ten to reflect
5 the page where Mr. Pagliara describe his time at
6 Hilliard Lyons, which is, H-I-L-L-I-A-R-D,
7 L-Y-O-N-S.

8 Q Mr. Pagliara, can you define the title
9 that you've listed for us on page ten which looks
10 like an acronym for your job there?

11 A My last position was senior vice
12 president.

13 Q What was your first position when you
14 joined Hilliard Lyons?

15 A Vice president. Vice president branch
16 manager.

17 Q Tell us about your first position at
18 Hilliard Lyons and whether you were serving
19 clients in that role.

20 A I opened an office in Franklin for
21 Hilliard Lyons and I took over the management of
22 their office in Nashville. So, I was in a dual
23 role of branch management and the -- you know,
24 client -- and servicing clients at the same time.

25 Q Did that branch offer both advisory and

1 brokerage services?

2 A No.

3 Q What services did it offer?

4 A Just brokerage. We had a trust company
5 that was separate from the -- the firm. It was
6 set up as a separate entity, but we were able to
7 offer trust services apart from the brokerage
8 side.

9 Q And you remained at Hilliard Lyons until
10 the year 2000?

11 A Yes.

12 Q While you were at Hilliard Lyons did you
13 ever provide advisory services to customers?

14 A Not that I was compensated for. I
15 always viewed what I was doing was advisory
16 service, but we weren't compensated that way.

17 Q Well, let me rephrase.

18 Were you -- you were acting as a
19 registered representative of Hilliard Lyons,
20 correct?

21 A Yes.

22 Q Were you also registered as an
23 associated person of any advisory service offered
24 through Hilliard Lyons?

25 A No.

1 Q Okay. So, Hilliard Lyons was not acting
2 as an investment adviser in terms of the branch
3 where you were working?

4 A No.

5 Q Was your first position working as an
6 associated person of an investment advisor with
7 CapWealth Advisors, LLC?

8 A I don't remember the exact timing. I
9 may have taken 65 towards the very last part of my
10 career at Hilliard Lyons. I'm not -- I don't
11 recall, but somewhere between 19 -- say 1999 and
12 2000 that's where it started.

13 Q Tell us about -- did you go directly
14 from Hilliard Lyons to working at CapWealth?

15 A I actually worked at -- I was part of --
16 it was called CAP Trust, LLC. They were the
17 umbrella organization that handled all of the
18 advisory work that we did.

19 Q And let me jump in real quick. So, is
20 that name is that CAP Trust, C-A-P, T-R-U-S-T?

21 A Yes, LLC.

22 Q Okay. Go ahead and continue describing
23 what CAP Trust, LLC is.

24 A It was a very short-natured -- it was a
25 venture of IJL Wachovia that provided a platform

1 that allowed us to run our businesses
2 independently with the umbrella of them providing
3 regulatory and compliance and all those different
4 services.

5 Q Did that end up becoming CapWealth, LLC?

6 A Eventually the CAP Trust, LLC went out
7 of business with the merger of IJ -- they -- they
8 merged it into Wachovia and First Union. So, it
9 ceased to exist in the format that it was when I
10 joined them in, I believe, it was February of
11 2000. And so, after it merged into the entity of
12 First Union and Wachovia I transferred the
13 regulatory burden of whatever, you know, and the
14 clearing and all of that to NBC Securities.

15 Q So, let's back up a little bit just to
16 kind of work through the chronology of your
17 employment.

18 Were you recruited by someone in
19 particular to go to CAP Trust?

20 A I was actively seeking employment away
21 from Hilliard Lyons following their merger with
22 PNC Bank throughout 1999. And so, I -- I actively
23 persuade CAP Trust and a number of opportunities,
24 evaluated all of them in the Fall of 1999 and then
25 joined CAP Trust in, I believe, it was February of

1 2000.

2 Q I think just for the record you said you
3 were evaluating the options in 1989. Did you mean
4 1999?

5 A 1999, that's correct.

6 Q Sure. So, how did -- how did CapWealth
7 Advisors come to exist?

8 A After the experience with CAP Trust in
9 2000, the short nature of that, then I chose to go
10 to NBC Securities, but still operated as -- as
11 CapWealth Advisors. The NBC Securities did a
12 merger with RBC Securities and they were
13 attempting to change our business model again
14 and -- and -- and put us into the RBC platform.
15 And so, it was at that point that we established
16 our own broker-dealer and our own registered --
17 independent registered investment advisory
18 organization.

19 Q And what were the names -- I asked, what
20 were the names of those entities?

21 A CapWealth Investment Services and
22 CapWealth Advisors.

23 Q So, CapWealth Investment Services or
24 CWIS, that was the broker-dealer, correct?

25 A Yes.

1 Q And then CapWealth Advisors, LLC is the
2 advisory firm?

3 A Yes.

4 Q And were you both a registered
5 representative of CWIS and an associated person of
6 CapWealth Advisors, LLC?

7 A Yes.

8 Q When those were formed did you do that
9 on your own or was there any other owner or
10 business, you know, partner that was participating
11 in that -- formation of those two entities?

12 A It was just me.

13 Q So when CapWealth Advisors and CWIS were
14 initially --

15 (Reporter asks for clarification.)

16 A I was 100 percent owner of both CWIS and
17 CWA. There were no partners in those instances.

18 Q And that was going to be my next
19 question about ownership percentages. So that
20 answered my next question.

21 Did the ownership -- had the ownership
22 for CapWealth Advisors changed over time?

23 A We now have a holding company with
24 CapWealth Group and I have a profit interest
25 partnership in which I have made grants of

1 ownership in the parent company to various members
2 of my team. So, they're on a schedule to vest in
3 the grants that I've given them over a ten-year
4 time and it's part of a plan of succession. So
5 that after I retire I will have transferred the
6 ownership of the firm to them.

7 Q How much ownership do you have today in
8 CapWealth Group, LLC?

9 A It would be over 80 percent.

10 Q And what year would you anticipate
11 having fully transferred all of the ownership away
12 from yourself to others?

13 A I don't know. I haven't put that on a
14 schedule yet.

15 Q The vesting though of ownership stakes
16 to some degree has started already in other people
17 though?

18 A Yes.

19 Q Can you run through, as far as you best
20 recall, who owns the other 20 percent of CapWealth
21 Group as of today?

22 A Phoebe Venable owns 15 percent and she
23 was just granted five. Her vesting to five years
24 into a ten-year vesting schedule.

25 Q Let me jump in real quick though. She

1 currently has five percent that has vested, but it
2 will continue to increase over time?

3 A It will increase over time.

4 Q And as you go through her answer -- go
5 ahead.

6 A I was going to say, I don't want to
7 speculate on that. We've got a detailed schedule
8 of each one of the -- the people that have
9 ownership and their vesting schedule. The vesting
10 schedule is -- there's no vesting for three years
11 and then it starts. And so, if you were going to
12 ask me specific questions about the ownership, I
13 would rather just submit those documents to you on
14 a supplemental basis because I don't -- all I'm
15 going to be doing is guessing and I'll be wrong.

16 Q Understood.

17 A I can -- I can -- I can tell you who has
18 some interest. I cannot tell you what their
19 vested interest is at this point. And I can
20 approximate it if that would be helpful.

21 Q So, we're only asking you today to tell
22 us what you do recall. And if something is not
23 certain, just let us know that. The best thing --
24 we will ask Mr. Bulso -- through Mr. Bulso for a
25 copy of that vesting schedule, but why don't you

1 go ahead now and just, as far as you can best
2 recall, tell us who the other individuals are that
3 have a ownership stake in CapWealth Group. And if
4 you could identify what their work roles are if
5 they also work for some part of CapWealth Group,
6 such as -- starting with Ms. Venable. If you can
7 identify what their current roles are.

8 A Phoebe Venable has approximately five
9 percent -- 15 percent interest in the firm. She
10 is chief executive officer. Ryan Hitt owns one
11 percent -- has a one percent interest in the firm
12 and he is chief technology officer and compliance
13 officer -- executive vice president, chief
14 technology and compliance officer. Traci Olive is
15 executive vice president and head of client
16 services. She has a one-and-a-half percent
17 interest.

18 Jennifer Pagliara is an executive vice
19 president and client services representative. She
20 has a five percent interest. Travis Pagliara, a
21 trust that I own, has a -- Travis Pagliara is the
22 beneficial -- has a beneficial interest in has a
23 three percent interest in the firm. And best of
24 my recollection, that's the ownership structure of
25 the firm.

1 Q Is Travis Pagliara a relative of yours?

2 A He's my son.

3 Q Does Travis Pagliara work in any way
4 with CapWealth Group or CapWealth Advisors?

5 A Not presently.

6 Q Did he in the past?

7 A I employ him as a consultant from time
8 to time to help me evaluated on some very complex
9 medical drug situations and companies that we were
10 evaluating. Travis is a doctor, an MD, a surgeon,
11 who has a biomedical engineering degree, a math
12 degree, masters degree in finance. And his
13 insight on some of the assignments I gave him and
14 helping me evaluate drug protocols and things like
15 that were helpful, but he's employed full-time now
16 as a surgeon and is not employed by us.

17 Q So, he does not currently work in the
18 securities industry?

19 A No. He's never worked in the securities
20 industry.

21 Q Okay. What positions do you currently
22 hold yourself at CapWealth Advisors?

23 A I am chairman and chief investment
24 officer.

25 Q During your time at CapWealth -- I'm

1 sorry, go ahead.

2 A And I work individually with clients,
3 directly with clients.

4 Q Understood. Apart from those roles,
5 have you ever held any other roles at CapWealth
6 Advisors during your time working there?

7 A I think I've worn just about every hat
8 in the organization at one point in time from
9 compliance to -- virtually every -- every title.
10 As the firm's grown, you know, I've hired people
11 and designated them as being responsible for those
12 particular aspects of -- of -- of operating the
13 firm.

14 Q As far as you can recall, at what time
15 period did you have a compliance role with
16 CapWealth Advisors?

17 A I don't understand the question. Could
18 you repeat it?

19 Q I can rephrase.

20 Was there a specific time period in
21 terms of certain years where you were serving as a
22 compliance officer for CapWealth Advisors?

23 A Well, initially I would have considered
24 myself a compliance officer and I would have held
25 that role and been involved in that role, I guess,

1 since the -- the start of -- of the firm.

2 Now, the official designation of that
3 role, the change probably occurred some time in --
4 I don't remember exactly when I designated Phoebe
5 chief executive officer, but, you know, we were
6 both actively involved in that in our -- from 2015
7 on -- I mean 2014 on.

8 Q Is it correct that Ms. Venable joined
9 the firm around 2011?

10 A I don't remember, but I thought more
11 recently. I think that's probably accurate, but I
12 don't remember the specific date she joined the
13 firm.

14 Q Did you assume the chief compliance role
15 for CapWealth Advisors from 2000 until Ms. Venable
16 arrived around 2011?

17 A Well, I -- I had Scott Roland -- by 2011
18 Scott Roland was the chief compliance officer of
19 CapWealth. And so, Ms. Venable didn't have
20 anything to do with compliance when she first
21 joined the firm. Her role was to -- was to assist
22 me with client services and working with clients
23 to handle the overflow peak in service and meet
24 with clients.

25 Q And did Scott Roland join prior to Ms.

1 Venable?

2 A Yes.

3 Q Do you recall approximately what years
4 Scott Roland joined the firm?

5 A I believe he went on payroll in 2008.

6 Q Was there ever a formal compliance
7 officer at the firm before Mr. Roland arrived?

8 A No, that was handled by the -- by NBC
9 Securities and -- and CAP Trust prior to that.
10 The official designation of a compliance officer
11 occurred when we set up CWIS and CWA some time in
12 I think it was 2009-2010. I don't recall the
13 exact date.

14 Q Okay. How many clients do you directly
15 serve today?

16 A You know, at some point in time I worked
17 with all of them. I work with the advisors and
18 helping them. I would say that as far as just
19 direct responsibility where, you know, I interface
20 recently with the client it's probably 30
21 families -- 30 to 50 families.

22 Q 30 to 50 families today?

23 A Yes.

24 Q And the firm has about how many clients
25 overall today in terms of advisory clients?

1 A We look at it as families and, you know,
2 at least somewhere around 600 families.

3 Q And do most of those families have more
4 than one account?

5 A Yes.

6 Q So, I think on the most recent Form ADV
7 for the firm I've seen there's over 1,000 clients
8 reported. Does that mean there's more than 1,000
9 client accounts?

10 A Yeah, there's more than 1,000 client
11 accounts.

12 Q Are most of your clients that you serve
13 discretionary accounts?

14 A Yes.

15 Q Would you characterize the number of
16 advisory accounts that you serve which are
17 discretionary as being higher than 90 percent
18 discretionary?

19 A Yes.

20 Q Has that been consistent since 2009?

21 A Yes.

22 Q And I -- I say 2009 because that was I
23 think the year that CWIS was created as the
24 affiliated broker-dealer, correct?

25 A Yes. And CWA was created during the

1 same time period simultaneously.

2 Q Tell us about the mix of clients that
3 you serve in terms of their objectives and
4 whatever mix of objectives you generally deal with
5 for those clients.

6 A Could you be more specific on the
7 question?

8 Q Sure. I mean, before we were talking
9 about your clients in your prior position. Are
10 you continuing to serve mostly retirees or is
11 there a different mix of clients that you now
12 serve at CapWealth Advisors?

13 A You know, I have people that are retired
14 and that doesn't, you know, typically designate
15 someone that's over the age of 65. I've got
16 people that have sold businesses that are retired
17 can be as young as 35. I've got entertainers that
18 are working, but essentially retired and living
19 off of assets they've accumulated.

20 I have clients that are actively
21 planning for retirement and saving money. I've
22 got clients that are inheriting wealth. I've got
23 clients that are actively working that we help
24 them manage their 401Ks. So, we've got, you know,
25 a broad range of services.

1 You know, I -- we work with the children
2 of clients that are in their 20s and 30s helping
3 them with their objectives. So, it's a -- it's a
4 very broad range of -- of objectives and clients
5 that we work with.

6 Q And that's what I'm trying to tease out
7 is just to learn a little bit more about the types
8 of clients and the ones you serve directly. So,
9 I'll just -- I'll say, it's my understanding the
10 firm does have high net worth clients, but also
11 other types of clients such as you just described
12 including children of high net worth clients that
13 might have smaller accounts; is that correct?

14 A Yes.

15 Q Do you tend to -- with the clients you
16 directly serve and advise, do you tend to mostly
17 work with only high net worth clients?

18 A Yes, but we probably should define what
19 you mean by high net worth before we go any
20 further. How do you define that?

21 Q Well, what -- what would you define as a
22 higher net worth client yourself?

23 A Over 15 million.

24 Q Would you characterize most of the
25 advisory clients you directly serve as having more

1 than 15 million in assets at CapWealth Advisors?

2 A The clients that I work with, yes.

3 Q Most of them would fall into that
4 category?

5 A Yes.

6 Q Do you, however, also serve any of their
7 client -- any of their children with smaller
8 accounts as well?

9 A Yes.

10 Q Does CapWealth -- well, let me rephrase
11 the question.

12 Who's the CapWealth current
13 broker-dealer that's used for advisory clients
14 accounts?

15 A We don't have a broker-dealer. We
16 switched -- we custody at Charles Schwab in their
17 RIA program.

18 Q So, there's -- there's not any
19 affiliated broker-dealer today, correct?

20 A No, there's no affiliated broker-dealer.

21 Q CWIS ended operations in the past,
22 correct?

23 A Yes.

24 Q When was that?

25 A It officially closed I believe in June

1 of 2018. We submitted the form to shut it down,
2 you know, earlier than that, but it effectively
3 was shut down completely and everybody's
4 registration terminated with FINRA I believe in
5 June of 2018.

6 Q Did CWIS or CapWealth Advisors ever have
7 any type of revenue sharing arrangement with any
8 other broker-dealer?

9 A No.

10 Q I want to move on now to the topic of
11 12b-1 fees.

12 Mr. Pagliara, do you know what 12b-1
13 fees are?

14 A Yes.

15 Q What do you understand 12b-1 fees to be?

16 A From a historical perspective or -- or
17 just -- you know, I can give you a historical
18 perspective of how they started in the industry --

19 Q No. No. No.

20 A -- if that makes sense.

21 Q We'll start simple. What do you
22 understand them to be in terms of today?

23 A They are reimbursement by the mutual
24 fund companies for services that were performed in
25 an advisory and administrative role in helping

1 them assist their clients with their goals and
2 objectives.

3 Q In other words, does that mean they are
4 generated by purchases of mutual fund shares?

5 A They can be, but they -- that's one way
6 of -- of generating a 12b-1 fee.

7 Q And is it your understanding do they
8 continue to be incurred as an individual or entity
9 holds mutual fund shares?

10 A It depends on the class of shares,
11 but -- but yes. So, if they're in a class of
12 shares that there's a 12b-1 fee, yes.

13 Q So you understand that a fund can have
14 multiple share classes, correct?

15 A Yes.

16 Q And you understand that some share
17 classes of a fund may charge 12b-1 fees while
18 other shares classes of a fund may not?

19 A Yes.

20 Q How long have you had that understanding
21 about the distinction of mutual fund share
22 classes?

23 A I don't know, since 1986, 1987 when
24 12b-1 fees were created.

25 Q So, 12b-1 fees were something that you

1 became familiar with while you were working at
2 Edward Jones?

3 A Yes.

4 Q Did you ever receive 12b-1 fees when you
5 were working as a registered representative at
6 Edward Jones?

7 A I believe they were just starting when I
8 left maybe in 1989.

9 Q And what -- so, did you ever receive
10 12b-1 fees while you were working at Hilliard
11 Lyons?

12 A I believe so, yes.

13 Q And have you received them while working
14 through CapWealth when CWIS was in existence?

15 A Yes.

16 Q Do you understand that 12b-1 fees
17 typically have a range in terms of the amount of
18 basis points that they cost a client?

19 A As they've evolved, yes.

20 Q And what do you understand the usual
21 or -- or ordinary range of 12b-1 fees to be
22 approximately?

23 A I don't know now because we have -- you
24 know, we terminated that part of our business in
25 June of 2018 and we don't -- you know, we don't

1 own share classes of 12b-1 fees.

2 Q When CWIS came into existence in 2009
3 did it start receiving 12b-1 fees through client
4 investments in mutual fund share classes at that
5 time?

6 A Yes.

7 Q And did that continue until CWIS ceased
8 operations in 2018?

9 A Yes.

10 Q Did the firm -- did CWIS between 2015 to
11 2017 typically bring in around \$200,000.00 or so
12 annually in 12b-1 fees?

13 A I don't recall that number -- the exact
14 number.

15 Q Does that number sound like that would
16 be within the realm of the approximate amount of
17 12b-1 fees that you recall coming in through CWIS
18 in 2015 to 2017?

19 A It may have been accurate in the front
20 part of that date range, but, you know, it was
21 tailing off significantly I think towards the end.

22 Q Walk us through, for 12b-1 fees that
23 came in through a CapWealth advisory client's
24 investment, how those 12b-1 fees were received as
25 compensation by CWIS and/or any registered

1 representatives of CWIS such as yourself.

2 And let me -- and what I can do to
3 clarify the question is, did you personally
4 receive a portion of the 12b-1 fees and did CWIS
5 retain and keep any portion of the 12b-1 fees?

6 A Well, any of the 12b-1 fees that were
7 collected in CWIS were -- were paid -- they were
8 designated as revenue and -- and they were paid to
9 us from CWIS.

10 Q Well, that's what I'm trying to
11 understand. So, who were the registered
12 representatives that would have been receiving the
13 12b-1 fees as compensation at CWIS?

14 A It would have been me, Tim Murphy and
15 Mark Willoughby.

16 Q And is there a distinction in terms of
17 the amount of the 12b-1 fee compensation that Mr.
18 Murphy, Mr. Willoughby or you received depending
19 on whose client was generating the 12b-1 fee?

20 A It would have been they came in in a
21 lump sum and they were designated to the rep that
22 owned -- that had the -- the funds in their
23 particular client base.

24 Q For example, for Mr. Murphy, did he get
25 100 percent of the 12b-1 fees that came in from

1 his client investments?

2 A Yes. Well, subject to whatever revenue
3 sharing arrangement existed for his portion of the
4 expenses related to occupancy and other things
5 with CWIS, yes.

6 Q So, there was an arrangement between Mr.
7 Murphy and CWIS?

8 A I don't remember if it was directly
9 between Mr. Murphy and CWIS. It was -- it was
10 related to the total revenue that he generated
11 from CWIS and CWA.

12 Q And I'm not trying to ask any trick
13 questions here. I'm just trying to understand as
14 best you recall how the 12b-1 fee came in as
15 compensation through CWIS and who ultimately
16 received any portions of those dollars from 12b-1
17 fees.

18 So, how about we start with just talking
19 about 12b-1 fees that you ended up receiving. Did
20 you receive any of them specifically as
21 compensation that you personally took home?

22 A My compensation was from my clients and
23 the profitability of the firm. So, yes.

24 Q So, walk us through if a 12b-1 fee came
25 in from a client's investment -- an advisory

1 client's investment, but who had a brokerage
2 account through CWIS, where did that 12b-1 money
3 go to? Would it come in from the fund to CWIS and
4 then it would be split up in some way between you
5 and CapWealth Investment Services? Or how did it
6 work out in terms of the flow of the 12b-1 fee
7 money?

8 A It was paid to me subject to -- you
9 know, as it was collected.

10 Q Okay. Was any portion of the 12b-1 fees
11 from your client account maintained by CapWealth
12 Investment Services or CapWealth Group?

13 A Can you repeat that question?

14 Q Was any portion of the 12b-1 fees that
15 was generated by your client's investments kept in
16 any way by the firm as opposed to being paid out
17 to you as compensation?

18 A Well, it would be like any dollar of
19 revenue, a portion of it is always retained to
20 cover expenses.

21 Q And how is that calculation determined
22 in terms of how much is kept by the firm for
23 expenses?

24 A Well, it was whatever net profits were
25 after expenses was paid out to me.

1 Q Okay. So, there was no set amount in
2 terms of a percentage that you were getting of
3 12b-1 fees? It was the left over net profit after
4 expenses?

5 A Yes.

6 Q And did you personally receive money
7 from CapWealth Group when -- in terms of
8 compensation that was brought in and then figuring
9 out net profit after expenses, was that through
10 CapWealth Group that you received your
11 compensation?

12 A All of my compensation was consolidated
13 through CapWealth Group and paid to me.

14 Q That was my question.

15 A So, again -- okay, good.

16 Q Are you familiar though, as far as the
17 other registered representatives, Mr. Murphy and
18 Mr. Willoughby, was their compensation determined
19 by some type of compensation grid?

20 A Repeat the question, please.

21 Q Was there a compensation grid that was
22 used to determine how much compensation the other
23 registered representatives, Mr. Willoughby and Mr.
24 Murphy, received?

25 A Yes.

1 Q Tell us about that compensation grid and
2 how you understand that it worked.

3 A In a very general way, without having it
4 in front of me, it was an attempt to -- a dollar
5 of revenue that they generated would have costs
6 associated with it. We would deduct those costs,
7 and not in a very specific way, but just as a
8 percentage of revenue, and then they were paid the
9 difference.

10 Q Okay. And I understand you're saying
11 you don't have the compensation grid in front of
12 you, correct?

13 A That's right.

14 Q Okay. So, we're going to -- we
15 essentially already asked for it, but we'll make
16 sure we follow-up to get that so we can,
17 ourselves, look at it and we'll let you know if we
18 have follow-up questions later.

19 Turning to your clients that you serve
20 directly through CapWealth. How did you choose
21 mutual fund share classes for your clients?

22 A Now, initially in 2000 we chose F1
23 shares, no commission, F1 shares for our clients.

24 Q And why -- why -- when you say F1
25 shares, why were you choosing F1 shares?

1 A The majority of our business was done
2 with Capital Research and Management and American
3 Funds and that's what they had designated
4 available for advisory accounts.

5 Q And how did you understand that's what
6 was available?

7 A That's all it was available. If we
8 wanted to provide our clients -- they were --
9 initially they were, you know, low weight -- they
10 had low weight A shares where you would just get a
11 12b-1 fee. And then they formally designated that
12 with F1 shares where you were only compensated for
13 the 25 basis point reimbursement for your help in
14 administering the account.

15 Q And when you say you typically were
16 choosing F1 shares, did you arrive at that
17 decision yourself by looking at a prospectus for
18 each fund or was there some other way that you
19 actually chose the shares you recommended and
20 chose for a client?

21 A Those were in the prospectus, yes. I
22 mean, by prospectus that's how they were
23 designated. And we had -- the industry was going
24 through changes. I felt like the commission model
25 was broken and the advisory model with the

1 collection of those servicing fees, as I believe
2 they were at the time, was the -- was the future.

3 Q Well, when you say you believed the
4 commission model was broken, what do you mean by
5 that?

6 A Well, in -- in 1987 when 12b-1 fees were
7 created, they were done at a tremendous amount of
8 study with Peter Drucker who was the -- you know,
9 widely regarded as one of the top management
10 experts of our time and the Securities
11 Administration Association. And he -- he said you
12 are paying clients -- clients are paying you for
13 things that -- it's really not the value you add
14 and it's not fair to them.

15 And so, the industry went from a model
16 where mutual funds were eight-and-a-half to nine
17 percent, they cut the commission to
18 five-and-three-quarters percent, plus the 25 basis
19 point trail. By 2000 when I established
20 CapWealth, you know, I didn't even think that was
21 fair because what I was paying clients for, as Mr.
22 Drucker had indicated in his analysis back in the
23 late '80s, I was giving them advice. I was paying
24 them and the industry was -- the whole
25 compensation in the industry was over

1 transactions.

2 And, you know, as I discussed it with
3 clients when I changed my business model in 2000,
4 I said, you know, if I charge you a
5 five-and-three-quarters percent commission that's
6 like you paying the guy that cuts your grass five
7 years in advance for the advice that he's going to
8 provide you. And so, I thought that the advisory
9 business with that 12b-1 fee was a more equitable
10 way of reflecting the value that I was adding to
11 their, you know, goals and objectives and
12 achieving and maintaining financial security and
13 what the industry had to offer at the time.

14 Q You mentioned Mr. Drucker with a D?

15 A Yes.

16 Q Can you spell that name for the record?

17 A D-R-U-C-K-E-R.

18 Q And what was --

19 A Peter.

20 Q Peter, P-E-T-E-R?

21 A Yes.

22 Q Going back to CapWealth clients though.
23 Once CWIS was in existence, so, basically, the
24 last decade or so from 2009 until CWIS ended in
25 2018, how did you specifically for your clients

1 look through and decide which share classes of
2 which funds you were going to choose for a client
3 to invest in?

4 A I would buy the share class that was
5 available that reflected the F -- that reflected
6 the advisory relationship that I had with the
7 client.

8 Q Well, I feel like we're missing a step
9 here. So, let's -- let's back up a little.

10 Were there models that you looked at at
11 CapWealth that looked at potential funds to
12 consider for them to invest in, for clients to
13 invest in?

14 A The majority of my business was done
15 with Capital Research and Management. And that
16 was the model that they had and that's what I
17 used.

18 Q So, tell us a little more about Capital
19 Research and Management. What is that?

20 A Well, it's one of the largest asset
21 management firms in the world. I believe they
22 manage almost \$2 trillion worth of assets. They
23 have a very unique style in managing assets.
24 They're very, very client friendly. I respect
25 their investment management process. And they've

1 been my business partner essentially since I
2 started in the industry and was first licensed.
3 I've worked with their funds for, you know, 38
4 years -- 38 plus years.

5 Q Well, tell us about the relationship.
6 You said -- you used the term partner, what do you
7 mean by that? Is there an actual written
8 agreement between CapWealth and that entity?

9 A There's a broker-dealer arrangement that
10 allows me to sell their funds, but when I consider
11 them a parter, you know, one of the things that's
12 important to me when I look at the landscape, you
13 have to be dealing with people that you can trust.
14 You have to be dealing with process. You've got
15 to be dealing with, you know, what's fair and --
16 and I felt like that they have been kind of a
17 beacon of -- of consistency in the industry.
18 And -- and so, I -- you know, I -- I work with
19 them. I like that, you know. They -- they have a
20 very cost effective structure for my clients.

21 Q Just so I can make sure I'm clear. This
22 is the investment company that has the American
23 Funds?

24 A Yes. Capital Research and Management is
25 the parent company -- is the holding company of

1 the American Funds Group.

2 Q And so you're saying -- is it correct to
3 say you typically have invested clients into
4 American Funds?

5 A Yes.

6 Q How did you choose which specific funds
7 you would invest clients in?

8 A You know, towards -- as we developed
9 more of our internal capabilities and success, you
10 know, with individual securities, mutual funds
11 became a -- a much smaller percentage of our total
12 revenue from 2000 on. So, we used Capital
13 Research and Management for accounts that were too
14 small to own individual securities. And we used
15 some of their funds to supplement client accounts
16 in areas where we didn't have specific expertise
17 like international investing or some other type of
18 investment that was specific to a fund that they
19 managed.

20 Q Were there certain types of American
21 Funds -- and I'm not getting to the share class
22 level yet, but just the specific type of funds
23 that you tended to use over and over for multiple
24 clients?

25 A Yes.

1 Q Did you collect or keep track of those
2 in any way such as a fund model or a fund menu
3 that you used internally at CapWealth?

4 A Eventually we did. We did eventually
5 create fund models.

6 Q Tell us about when you recall the models
7 starting to be created.

8 A It would have been some time probably
9 2014 maybe.

10 Q And did the models go to the level of
11 recommending share classes of the specific funds?

12 A That would have been -- yes, that would
13 have been in the model.

14 Q And were 12b-1 fees, were they a factor
15 in terms of choosing which share classes were
16 listed on the model?

17 A No.

18 Q Did 12b-1 fees factor at all into the
19 share classes that you did ultimately recommend
20 and choose for clients?

21 A No.

22 Q You were receiving 12b-1 fees though
23 from client investments on a regular basis though,
24 correct?

25 A Yes.

1 Q So, if the 12b-1 fees didn't factor into
2 the analysis why choose the share classes that had
3 12b-1 fees?

4 A Well, they were there. I mean, 12b-1
5 fees were present in -- were present at that time.
6 And you have to go back into the period 2000 to
7 2009-2010. If -- if I've got F1 shares at Charles
8 Schwab and I didn't collect those 12b-1 fees,
9 Charles Schwab was collecting them. They were
10 there. It is -- you know, they weren't paid to me
11 directly. They were paid to the custodian, the
12 broker-dealer. And so, the clients incurred those
13 costs regardless. And that's when the industry
14 started changing. In 2015 there was a
15 proliferation of different share classes.

16 Q Are you familiar with American Funds and
17 the F2 share class?

18 A Yes.

19 Q What do you understand the F2 share
20 class to be as compared to the F1 share class for
21 American Funds?

22 A The F2 share class was something that
23 they created that eliminated the 12b-1 fees that
24 were paid to an adviser. And they paid 20 basis
25 points, I believe, or some compensation to the

1 custodian like Charles Schwab.

2 Q And do you remember how far back F2
3 shares were generally available through American
4 Funds?

5 A No. Somewhere in the time frame of
6 2015.

7 Q Did you generally review and look at
8 prospectus materials for funds to see if F2 shares
9 were available as opposed to F1 shares for
10 American Funds?

11 A I believe I would have, yes.

12 Q And is that something you did as far
13 back as 2009 when CWIS was created?

14 A Yes.

15 Q If there was a class -- or let me say,
16 if there was a fund you were looking at for
17 clients that you thought was an appropriate
18 recommendation for clients and it offered both an
19 F1 share and an F2 share in 2015, did you
20 typically choose the F1 share?

21 A We were starting to migrate to F2 shares
22 at that point.

23 Q And why was that?

24 A That were available. Probably because
25 they provided lower costs for the client.

1 Q Well, let's -- let's stop there. Before
2 you talk about migrating, before 2015 was
3 CapWealth and you, were you typically -- if you
4 were making a mutual fund selection to the F1
5 share over the F2 shares?

6 A I don't remember. You're attempting to
7 play a game of gotcha here that started with a
8 process that made this industry, and continues to
9 make this industry, better for clients. And so,
10 why don't we just cut to the chase of what you're
11 trying to get to instead of asking these questions
12 about what was done 15 years ago or five years ago
13 that no one would remember. What is it that
14 you're getting after?

15 Q Well, Mr. Pagliara, I'm not playing a
16 game. I'm simply conducting an investigation and
17 we're trying to work through what the business
18 model was and understand the business model at
19 CapWealth as it existed years ago when CWIS first
20 came into affect. And we want to understand how
21 it changed over time. And we're trying to make
22 sure we don't skip steps and understand what
23 changed and what was the process in terms of how
24 things were selected.

25 So, we're not playing any type of gotcha

1 game. We're simply trying to ask questions and
2 make sure we give you a fulsome chance to explain
3 the business model, how it changed over time. And
4 if I'm asking lots of questions it's because I
5 want to make sure I don't put words in your mouth.
6 I want to make sure I fully give you a chance to
7 explain things as we move through the time
8 continuum that we're investigating. Does that
9 make sense?

10 A I disagree with your characterization of
11 that, but go ahead, continue to ask your
12 questions.

13 Q Why don't we -- we'll move on to a
14 different topic, but we'll still be able to talk
15 about the F1 and the F2 shares through this.

16 So, is there an investment committee at
17 CapWealth?

18 A There's an investment policy committee,
19 yes.

20 Q Tell me about the investment policy
21 committee in terms of who is on it and what it
22 does.

23 A The investment policy committee consists
24 of me, Phoebe Venable, Ryan Hitt, Grant Stark,
25 Drew O'Connell, Jennifer Paglia, and Hunter

1 Yarbrough.

2 Q So, there's a couple of names that I
3 don't think I've encountered before. So, if I
4 could go over those.

5 Brad Stark is the first one. Could you
6 spell the last name for us?

7 A Grant Stark, S-T-A-R-K. He joined my
8 firm as director of research March 1st.

9 Q Of 2020?

10 A Yes.

11 Q And then I think the next name that you
12 provided was Drew O'Connell.

13 A Yes.

14 Q And is that O apostrophe C-O-N-N-E-L-L?

15 A Yes.

16 Q And who is Drew O'Connell?

17 A Drew O'Connell joined the firm in March
18 of 2020 and he's a chartered financial analyst
19 just like Grant Stark is. And they're there to
20 beef up research and -- that is necessary as part
21 of our investment policy committee.

22 Q And the other name I was not familiar
23 with was Hunter Yarbrough. Could you spell the
24 last name for us?

25 A Y-A-R-B-R-O-U-G-H.

1 Q And who is Hunter Yarbrough?

2 A Hunter Yarbrough is executive vice
3 president and a client services adviser. He owns
4 the same designation -- same position that
5 Jennifer Pagliara has.

6 Q How often does the investment policy
7 committee meet?

8 A Every two weeks.

9 Q Are there minutes or notes created by
10 the meeting?

11 A Yes.

12 Q And who makes those notes?

13 A Depends on who's at the meeting.

14 Q Is there a secretary assigned for that
15 committee?

16 A There's a secretary assigned for the
17 meeting.

18 Q Are the notes regularly maintained in
19 any manner, such as, through a -- a shared server
20 or somewhere where people who are on the committee
21 can access them and see the notes from each
22 meeting?

23 A Yes, as well as, the research on the
24 companies that we -- that we maintain.

25 Q Walk us through what generally happens

1 at one of the regular investment policy committee
2 meetings.

3 A Typically we talk about the individual
4 companies, its latest earnings reports, how they
5 might specifically meet the objective of a client,
6 how they're integrated into one of the three
7 models that we maintain, which would be an equity
8 income model, a growth and income model and a
9 growth model.

10 Q And does the committee typically, as
11 part of its work, does it consider and look at
12 mutual funds as potential things to recommend for
13 clients?

14 A No. The mutual fund portion of what we
15 have is generally not discussed in that meeting.

16 Q Going back to when CWIS was in
17 operation. So, let's go back five years ago. Did
18 the investment policy committee exist then?

19 A I think we started it, yeah, about that
20 time on a more regular basis, yes.

21 Q Did the committee consider and look at
22 and review mutual fund options at that point?

23 A No, because we had a very limited menu.
24 You know, American Funds was our primary -- our
25 primary partner in what we did with mutual funds.

1 Q Was there ever a mutual fund model that
2 was used by CAP Wealth?

3 A No, because it's different for each --
4 every client was different and we were -- you
5 know, if you looked at our -- our investment
6 strategy for a client, about 80 percent of what we
7 did was with individual stocks. Mutual funds was
8 a small portion of it.

9 Q So, why don't we take a ten-minute
10 break. I think now is a good point to do that.
11 And we'll stop now.

12 MR. BASINGER: We're off the record at
13 10:59 a.m.

14 (A brief recess was taken.)

15 MR. BASINGER: So, we are back on the
16 record at 11:11 a.m. on Friday, May the 5th, 2020.

17 BY MR. BASINGER:

18 Q Mr. Pagliara, can you confirm that while
19 we were off the record that we did not continue
20 having substantive discussions of this matter.

21 A We did not have any discussions on this
22 matter off the record.

23 Q Thank you.

24 I'm going to close Exhibit 21 and I am
25 now going to open what was previously marked as

1 CAP Exhibit No. 5 which is an investment
2 management agreement. And I'm going to scroll to
3 the bottom of the page and show the stamp that was
4 previously placed upon this document as CAP-5.

5 And I'll note for the record, the Bates stamp on
6 the first page is CW 000910. I'm going to scroll
7 back to the top and I'm just going to ask --

8 A Can I correct? You that's 901.

9 Q Did I say 910?

10 A Yes.

11 Q I apologize. So, I'll say it again. So,
12 its CW 0000901. Thank you.

13 I'm going to scroll back to the top of
14 Exhibit 5 and I'll just ask as a starting point,
15 Mr. Pagliara, can you identify what this document
16 is?

17 A It's our investment management agreement
18 for discretionary accounts.

19 Q And are you familiar with this document?

20 A Yes.

21 Q What do you understand this document to
22 be and how is it used?

23 A It describes our relationship with our
24 clients and, you know, our responsibilities on
25 managing their accounts.

1 Q Has CapWealth used a similar document
2 since 2009?

3 A Yes.

4 Q How did CapWealth first come to draft or
5 prepare an investment management agreement like
6 this?

7 A I believe we did it with the help of an
8 outside consulting firm.

9 Q Did you, yourself have, any role in
10 drafting the content of the IMA?

11 A I reviewed it, yes, and would have had
12 some input into it, yes.

13 Q I'm going to go to the second page of
14 the document. And there is a section here at the
15 top of page two called, Section Five, with the
16 subtitle of, Management Fees. And you'll see
17 there's the -- there's the second paragraph which
18 reads, quote, Client understands that account
19 assets invested in shares of mutual funds or other
20 investment companies, quote, funds, end quote,
21 will be included in calculating the value of the
22 account for purposes of computing advisors fees
23 and the same assets will also be subject to
24 additional advisory and other fees and expenses as
25 set forth in the prospectuses of those funds paid

1 by the fund, but ultimately borne by the investor,
2 end quote.

3 Mr. Pagliara, are you familiar with this
4 language in the IMA?

5 A Yes.

6 Q What do you understand this language to
7 mean?

8 A That the client acknowledges that's how
9 we're going to be paid and that there may be
10 additional funds and -- additional fees and
11 expenses as set forth in the prospectus of those
12 funds paid by the funds but ultimately borne by
13 the investor.

14 Q For the phrase, quote, Additional
15 advisory and other fees and expenses as set forth
16 in the prospectuses of those funds, end quote, do
17 you have any understanding as to what those types
18 of advisory and other fees and expenses are with
19 any more specificity?

20 A They refer specifically, I believe, to
21 the 12b-1 fees that are at the heart of this
22 investigation.

23 Q Is there anything else that you
24 understand falls into the category of the advisory
25 and other fees and expenses noted here in the IMA?

1 A No.

2 Q So, your personal understanding as you
3 understand that that's a reference to the 12b-1
4 fees incurred from certain mutual fund
5 investments; is that correct?

6 A Other fees and expenses could -- you
7 know, they could incorporate legal, accounting,
8 the management fees of those particular funds.
9 So, it's kind of an all encompassing thing. So,
10 yes, it would be all of those. I'll correct my
11 previous answer.

12 Q You do understand it though in part as
13 including 12b-1 fees, correct?

14 A Yes.

15 Q Do you know who drafted this specific
16 sentence for the IMA?

17 A No.

18 Q Has it been used, as far as you can
19 recall, during the last five years or so in the
20 IMA?

21 A Yes.

22 Q Have you ever considered why it does not
23 go to the level of spelling out the fact that
24 12b-1 fees are included in what you understand to
25 be that phrase, advisory and other expenses?

1 A Could you repeat the question?

2 Q Let me rephrase the question.

3 Do you feel that this language as it's
4 written in the IMA in this paragraph is clear
5 enough for clients to understand that it
6 encompasses 12b-1 fees?

7 A Yes.

8 Q Why is that?

9 A Because this was a topic of extensive
10 discussion with the Securities and Exchange
11 Commission during their initial audit of our firm
12 in 2011 in which we discussed in great detail the
13 relationship between CWIS and CWA. They were in
14 my office for two weeks. They had, I believe, at
15 one time as many as eight examiners. We had a
16 very colloquial discussion about our business
17 model, the disclosures that we made to our clients
18 and this agreement is the basis upon which we have
19 done business since 2009 and 2011 after those
20 substantial discussions with your representatives
21 during the first field audit of my firm.

22 Q So, I'll just note for the record, I'm a
23 part of the Division of Enforcement. I think the
24 examination you're referring to is from a
25 different part of the SEC called The Office of

1 Compliance, Inspections and Examinations. I just
2 want to note that this enforcement investigation
3 today is not related to or part of that Office of
4 Compliance, Inspections and Examinations.

5 So, you're saying there was a prior on
6 site examination of the firm that took place, not
7 in 2019, but in a prior year?

8 A 2011. And you've been furnished a copy
9 of that audit and the findings from that audit.

10 Q And what specifically do you recall from
11 that exam that touched upon 12b-1 fees in 2011?

12 A That we discussed our business model,
13 how we used the 12b-1 fees. The purpose of
14 CapWealth Investment Services was to reduce fees
15 for clients. The question came up, Why don't you
16 just clear at a firm like Charles Schwab? Why
17 even have a broker-dealer? And the discussion
18 centered around it was our intent to be more cost
19 effective in how we set up our advisory agreement
20 and how we were compensated in our relationship
21 with our clients.

22 During those discussions we discussed
23 the three different areas that we received in
24 compensation and the expenses that a client
25 incurred. And we went into each one of those in

1 detail and why we did what we did, why it was
2 unique, why it resulted in overall lower fees to
3 clients. And they were very satisfied with that.

4 Q Is there anything else you recall from
5 that specific examination concerning 12b-1 fees?

6 A I can go into detail on all three
7 aspects of it if you'd like.

8 Q Well, my specific question is just
9 about, is there anything else about 12b-1 fees.
10 And this IMA is really what I'm focusing on right
11 now. Was there anything else concerning the
12 investment management agreement and 12b-1 fees
13 that you recall discussing with the SEC's exam
14 staff in 2011?

15 A Yes. There was a collateral -- also
16 examined CapWealth Investment Services. And there
17 was substantial discussion between the
18 relationship with both and the disclosures it
19 would make in collecting those 12b-1 fees. And
20 they opined on the adequacy of that, that if they
21 were -- we satisfied them.

22 They had some questions about the
23 disclosure of the trading fees that the
24 commission -- or transaction fee as it was
25 described. The transaction fees that we had of

1 14.95 and the relationship that we had with our
2 broker-dealer and the disclosure of that. And we
3 updated the disclosure based upon their
4 recommendations and followed exactly what they
5 asked of us as a follow-up to that audit.

6 Q Is it okay for me to proceed with my
7 other questions about this document now?

8 A You were never kept from doing that.
9 It's your deposition to proceed.

10 Q Oh, no. I'm not inferring you were
11 preventing me. I just wanted to make sure you had
12 a chance to tell us what you wanted to tell us
13 about that exam, the prior exam.

14 A You asked a question and I answered it.

15 Q Okay.

16 A I'm ready to answer your next question.

17 Q Okay. Turning back to page two of
18 Exhibit No. 5 here in this IMA for CapWealth. The
19 paragraph we're looking at there in section five,
20 it doesn't specifically use the term 12b-1 fees,
21 correct?

22 A No.

23 Q Did you ever consider updating the IMA
24 to include that term in this portion of the
25 document?

1 A No.

2 Q And is there a reason for that?

3 A I relied on the guidance and discussions
4 that I had during the field examination with the
5 Securities and Exchange Commission in 2011.

6 Q This portion of the document in the IMA
7 does not identify 12b-1 fees as a conflict of
8 interest, correct?

9 A No.

10 Q And if I scroll down to section eight
11 there is a paragraph that reads -- and I'm going
12 to highlight it for you. Can you see that
13 paragraph?

14 A Yes.

15 Q It reads, quote, Conflicts of interest
16 may arise in the allocation of investment
17 opportunities among accounts that adviser advises.
18 Adviser will speak to allocate investment
19 opportunities believed appropriate for clients
20 accounts and other accounts advised by adviser
21 among such accounts equitably and in a manner
22 consistent with the best interest of all accounts
23 involved, but there can be no assurance that a
24 particular investment opportunity that comes to
25 the attention of adviser will be allocated in any

1 particular manner, end quote.

2 Now, did you have any role in drafting
3 this language about conflicts of interest for the
4 IMA?

5 A I don't remember, but I -- no. I don't
6 remember.

7 Q That's fair. We only ask for you to
8 tell us what you do recall.

9 This specific language about conflicts
10 of identify does not identify 12b-1 fees in any
11 way, does it?

12 A No.

13 Q Did you ever consider whether this
14 section needed to be amended to address 12b-1 fees
15 in any way?

16 A No.

17 Q I'm going to turn to, or flip forward I
18 should say, in the document that's being
19 displayed, Exhibit 5, to page five which is
20 titled, Schedule A Investment Advisory Accounts,
21 Investment Management Agreement.

22 Mr. Pagliara, can you identify this
23 schedule A and if it has a specific use in terms
24 of -- or a relationship to the custodian that's
25 named in this document?

1 A Yes.

2 Q What do you understand to be the
3 specific use for this version of schedule A of
4 this the document?

5 A It was attached to the investment
6 management agreement that you referred to.

7 Q Do you see section two of the document
8 where it says, Custody of Account Assets?

9 A Yes.

10 Q The name of the custodian listed is,
11 Sterne Agee Clearing, Inc. What do you understand
12 Sterne Agee Clearing, Inc. to be?

13 A Sterne Agee Clearing, Inc. was the --
14 and I don't know the -- the technical side of it.
15 We were an introducing broker-dealer that had
16 nothing to do with the actual custody of the
17 documents and they had the full responsibility for
18 custody -- custody and clearing and where those
19 accounts resided.

20 Q And was there more than one custodian
21 that was used by CapWealth for its clients over
22 the course of the last five years?

23 A We changed -- we -- we added BNY
24 Mellon/Pershing in 2015.

25 Q And was that the migration you were

1 referencing a little bit earlier today of certain
2 accounts?

3 A Yes.

4 Q Tell us a little bit more about the
5 reason CapWealth was migrating certain clients
6 over to Pershing for custody of their assets?

7 A Sterne Agee had been involved in a -- a
8 pretty serious scandal that involved embezzlement
9 by their chairman and extended all the way into
10 the office of general counsel. The chairman,
11 chief -- chairman, chief executive officer and
12 chief operating officer, as well as, the general
13 counsel of the firm were removed by the
14 shareholders. And it had become clear as a result
15 of that that they had a lot of financial issues
16 and a lot of turmoil. And, as such, they were our
17 primary clearing firm and in the best interest of
18 our business and our clients, we aggressively
19 started a process to leave them and remove our
20 assets from Sterne Agee. And Pershing was the
21 firm that we picked to -- to do that.

22 Q And did that impact in any way
23 CapWealth, or its registered representatives that
24 worked there, receipt of 12b-1 fees once client
25 accounts were moved over to Pershing?

1 A Yes.

2 Q How did it impact their receipt of 12b-1
3 fees for those accounts?

4 A As part of the process of moving to
5 Pershing it was our intention to move everything
6 to Pershing and to eliminate CapWealth Investment
7 Services, just to shut it down. We saw that the
8 trends in the industry were giving clients more
9 choices and we wanted to be able to align ourself
10 with that. And so, this was the first part of the
11 move to -- to get them aligned with Pershing.
12 Pershing was just a custody firm similar to
13 Charles Schwab and we were in the process of
14 moving to a pure RIA platform.

15 Q And so, by doing that for accounts that
16 moved to Pershing, did that mean that CWIS and its
17 registered representatives could no longer receive
18 12b-1 fees through clients assets that were at
19 Pershing?

20 A That's correct.

21 Q What specifically happened -- let me
22 back up.

23 Did you have any clients yourself that
24 were part of that initial migration to Pershing in
25 2015?

1 A Most of them were my clients.

2 Q And which clients were moved, as far as
3 you recall? Was there a certain criteria used to
4 select those that were part of that migration?

5 A It was generally the higher net worth
6 clients and the clients that we had the best
7 relationships with that could withstand some of
8 the confusion that goes along with, you know, the
9 account transfer process account by account and --
10 and setting up new checking and new deposit and
11 ACH relationships and all of that. So, we wanted
12 to move our -- you know, our clients with the best
13 relationships first and -- and get a feel through
14 the learning process that accompanies a -- a huge
15 undertaking like that administratively to get it
16 done.

17 Q Did any of those clients, as far as you
18 recall, hold mutual funds that were charging 12b-1
19 fees such as through an F1 share class?

20 A Yes.

21 Q When the client assets were moved to
22 Pershing did they stay in the F1 share class or
23 did the share class change for those clients?

24 A I don't remember specifically. I think
25 we were attempting to move those, but I -- I don't

1 remember.

2 Q Do you recall if at any point while your
3 clients were at Pershing they were able to convert
4 their share classes to F2 share classes that had
5 no 12b-1 fees?

6 A I don't remember. Our intent -- our
7 intent was to convert everybody to F2 shares. And
8 my recollection was that Pershing was such a
9 disaster from what they promised us to what they
10 could deliver for the specific needs of our client
11 base that we never got to the point where we could
12 do a system wide conversion, which is a very
13 detailed process when you're converting share
14 classes. We never got to that point. It was a --
15 it was a bad experience.

16 Q When you talk about there was a -- the
17 terminology you used -- if you want to use a
18 different term, that's fine, but I thought you
19 said you had an intention of converting everyone
20 to F2 share classes at some point; is that
21 correct?

22 A Our intent was to shut down the
23 broker-dealer so that we wouldn't collect any
24 12b-1 fees and our intent was with the second wave
25 of clients that we were going to move to Pershing,

1 which were typically our smaller accounts, to
2 execute the fee increase and to eliminate
3 CapWealth Investment Services completely.

4 Q Why not go ahead while -- let me ask the
5 question though.

6 Why not go ahead in 2015 when clients
7 still had assets at Sterne Agee and convert them
8 to F2 share classes first while trying to figure
9 out whether Pershing was going to work or not?

10 A Thirteen days after we started the
11 execution of moving accounts to Pershing, Stifel
12 Nicolaus did what we knew was going to happen
13 because of the financial problems that Sterne was
14 having, they bought Sterne Agee. Stifel Nicolaus
15 is a publicly traded broker-dealer, an advisory
16 firm, an investment banking and research firm.
17 They had a custodial platform. And everything
18 stopped at Sterne Agee. It was absolute chaos.
19 And executing a transaction where you converted
20 shares from one share class to another was
21 impossible. They were cutting staff and the firm
22 was getting held together, basically, with baling
23 wire as they went through that process that always
24 occurs when you're buying a distressed firm and a
25 firm with the kinds of problems that they had.

1 We were a -- we were the largest
2 independent registered investment adviser that
3 they had, but it was a stepchild to the problems
4 that existed within that firm. So, it wasn't even
5 a -- it wasn't even a possibility during that time
6 frame.

7 Q Before Stifel made its acquisition of
8 Sterne Agee were F2 shares available for purchase
9 for new clients through -- that -- that had their
10 assets custodied at Sterne Agee?

11 A Yes.

12 Q Did CapWealth ever choose F2 shares to
13 clients and buy them before the Stifel acquisition
14 of Sterne Agee?

15 A Yes.

16 Q In what situations did that take place?

17 A A variety of accounts. I had accounts
18 with F1 shares. I had accounts with F2 shares.
19 In January of 2016 or some time earlier in '17
20 American Funds announced that they were going to
21 have F3 shares. You know, it was a very difficult
22 period given the specific things that we had to
23 deal with with Sterne Agee and Stifel and the
24 problems that we associated with Pershing that we
25 had with Pershing.

1 Q Once Stifel did acquire Sterne Agee did
2 there come a point when new purchases were able to
3 be made again of mutual fund share classes?

4 A They were always available.

5 Q So, it wasn't even in that transition
6 phase that CapWealth was unable to make new
7 purchases for client accounts?

8 A Could you repeat that question? I don't
9 understand it.

10 Q Sure. I'll give you -- sure. Sure.
11 So, it sounded like before, you tell me
12 if I'm understanding correctly, you were
13 testifying that there were not conversions being
14 made for clients whose assets were custodied at
15 Sterne Agee when Stifel took over Sterne Agee
16 because there seemed to be a lot of technological
17 and other issues going on that made things
18 problematic. That's the way I understood that.
19 If you want to rephrase it, feel free.

20 A That's correct.

21 Q My question is, after Stifel did make
22 that acquisition, were you able to buy share
23 classes within a certain amount of time after that
24 acquisition was finalized? I'm just trying to
25 understand if there was a point where you couldn't

1 make any fund share class purchases at all?

2 A No. We could still purchase mutual
3 funds during that period.

4 Q So, you -- you could have for clients --
5 or let me ask, did you after the Stifel
6 acquisition make F1 purchases for clients? New
7 purchases that is.

8 A We probably did, yes, but I can't give
9 you any specific examples.

10 Q Do you think you also probably made any
11 F2 purchases through Stifel?

12 A Yes.

13 Q So, it sounded like earlier were you
14 talking about, there were problems that prevented
15 conversions from taking place for clients that
16 already held F1 shares that could have been moved
17 over to F2 shares?

18 A Yes.

19 Q Okay. So, that's what I was just trying
20 to just clarify what you were describing before in
21 terms of the situation as it was when Stifel took
22 over Sterne Agee. So -- go ahead.

23 A I'll wait for your question.

24 Q Is it fair to say you believed there
25 were issues at Stifel in terms of process, or what

1 have you, that made making share class conversions
2 for clients not something you saw as possible to
3 do at that time in 2015?

4 A Yes.

5 Q Okay. The new purchases for clients did
6 continue once Stifel had acquired Sterne Agee?

7 A Yes.

8 Q Okay. Going back to page five of
9 Exhibit No. 5, section three shows an advisory fee
10 schedule. Are you familiar with that advisory fee
11 schedule that's listed in section three?

12 A Do you -- are you putting it up on the
13 screen here? I don't see it on the screen.

14 Q Is this down here -- are you able to see
15 the PDF right now?

16 A Yeah. Now I see it. So, you're
17 referring to section three? Yes.

18 Q Correct.

19 A Yes.

20 Q Do you understand is that an advisory
21 fee schedule or do you call it something else?

22 A Yes. No, that would be an advisory fee
23 schedule.

24 Q Okay. It's my understanding, you know,
25 the document as it was produced didn't have a date

1 on it, but this is one of the ones that was given
2 to us. Looking at the fee schedule can you
3 identify approximately what year this might have
4 been in effect for CapWealth?

5 A It would have been in effect I think
6 during the entire period we were at Sterne.

7 Q So, prior to June of 2018?

8 A I believe so.

9 Q Okay. Did you typically use this
10 schedule with your clients?

11 A Yes.

12 Q Did you ever make any discounts for
13 clients in terms of the advisory fee in light of
14 12b-1 fees you were receiving for mutual fund
15 investments?

16 A Yes.

17 Q Tell us about that process and how you
18 would have calculated or determined a advisory fee
19 discount in light of 12b-1 fees.

20 A For example, I've got one client that
21 has \$10 million invested with me. They actually
22 operate off of a discount from our fee schedule.
23 And then, they have four children. Each of their
24 four children now have at least two children. So,
25 you have four and eight's 12. That client

1 individually has four different accounts. They've
2 got a trust account, they've got two joint
3 accounts -- they actually had more than that.
4 They have a SEP account and they have an
5 individual retirement account. And then each of
6 the children and each of the grandchildren have a
7 separate trust account that receives gifting money
8 that funds an irrevocable life insurance trust.
9 And each one of those accounts is set up
10 differently.

11 So, those accounts -- those -- the
12 children's accounts and the trust accounts and the
13 grandchildren's accounts, and I think we're up to
14 maybe 15 or 20 at this point, none of those are
15 subject to the advisory fee. They hold a variety
16 of mutual funds from American Funds Group. And
17 those accounts at that time would have been F1
18 shares so that we were receiving a 25 basis point
19 trail for administering those accounts and
20 providing services to those accounts.

21 Q So, would each of those clients have
22 filled out a investment management agreement for
23 each one of those accounts similar to the one we
24 see displayed here in Exhibit 5?

25 A Yes.

1 Q And if you determined you were going to
2 offer a discount or no advisory fee, how would
3 that be memorialized on that individual client's
4 investment management agreement?

5 A Well, if it was no investment advisory
6 fee -- and if you scroll down, there's a --
7 there's a -- another section --

8 Q On the next page?

9 A On the next page, yeah, the schedule.

10 Q Unfortunately, this is the way the
11 document came to me. So, it may not be what
12 you're expecting to see. It's looks like kind of
13 the same thing over and over. It's the family
14 schedule.

15 A Yeah. There would be a big family
16 schedule and it would show zero or whatever the
17 fee was, you know, and whatever the discount was.
18 Consolidated investment advisory fees and then you
19 can see there's a space in there where you could
20 put a discount in. Most of those accounts that I
21 just referenced, they would not have been subject
22 to an annual administrative fee. So, all of that
23 would have been spelled out.

24 Q Would you have done that in ink on the
25 paper document?

1 A Yes, and had the client initial it.

2 Q So, for example, if it was a -- a -- one
3 of the children's accounts would you have struck
4 through the administrative fee here?

5 A Yes.

6 Q And then would you have written -- what
7 would you have done if you were going to charge no
8 advisory fee on the child's account? Would you
9 write out, No fee charged, or just crossed out
10 this section or what would you do?

11 A It would have been zero there, but then
12 it would have been noted in our billing system
13 that there was no fee -- no administrative fee for
14 that particular account. So, it wouldn't -- it
15 wouldn't be collected.

16 Q I'm going to go back to page five real
17 quick.

18 So, for a schedule such as this one
19 where it has kind of tiered fee rates for
20 different asset levels, how would you
21 memorialize -- how would you memorialize which fee
22 you were going to charge a client using a version
23 of the agreement schedule like this?

24 A We would have written it in. You know,
25 back down to that percentage, that -- that

1 previous section that we just looked at where
2 there was a percentage option. So, some accounts
3 might be four tenths of one percent flat across
4 the board. It would be what we negotiated with the
5 client.

6 Q And did you ordinarily write that down
7 in ink as well?

8 A Yes.

9 Q And then you said it would be
10 memorialized in -- did you say in the billing
11 system?

12 A Yes. Then that would be reflected in
13 the billing system as well.

14 Q And which billing system is that that
15 you're referring to?

16 A It's the Advent billing system that we
17 use. It's a -- it's part of the Advent system.

18 MR. BASINGER: Steve, or, Kristin, did
19 you have any more questions on Exhibit No. 5
20 before I move on?

21 MS. MURNAHAN: I do not.

22 MR. DONAHUE: I do not. Thank you.

23 MR. BASINGER: I'm going to close
24 Exhibit 5 and I'm going to launch Exhibit No. 6.
25 And Exhibit No. 6 was previously marked yesterday

1 as CAP Exhibit No. 6. It is the Form ADV Part II
2 A Brochure for CapWealth Advisors with a date of
3 February 8, 2016.

4 Q I'll zoom in in a minute to make it
5 easier to read, but as a starting point, Mr.
6 Pagliara, are you familiar with Exhibit No. 6?

7 A Yes.

8 Q What did you understand this document to
9 be?

10 A Form ADV Part II.

11 Q And how is this document typically used
12 by CapWealth?

13 A It is handed to the clients and it's on
14 the website I believe of the SEC.

15 Q What do you generally understand this
16 document's content to include?

17 A It's a general discussion and
18 disclosure, you know, as required by the
19 regulatory -- by, you know, the regulator.

20 Q Do you recall any more specifically the
21 subsections of content that are within the
22 brochure?

23 A Not without looking at them.

24 Q Do you recall if the brochure typically
25 talks about the services provided by the firm to

1 clients?

2 A I'm sure it does, but I don't have any
3 specific --

4 Q Okay. Did you ever work on any editing
5 or review of this document on an annual basis
6 during your time at CapWealth?

7 A I would have been made aware of it. Now,
8 again, more actively involved with it in 2001,
9 2002 than I would have been in 2016.

10 Q Who, in the last five years or so, in
11 2015, who regularly had responsibility for
12 reviewing and updating this document on an annual
13 basis at CapWealth?

14 A Scott Roland, Ryan Hitt and Phoebe
15 Venable.

16 Q Is it fair to say that the
17 responsibility of reviewing and updating this
18 document during the last five years generally fell
19 to the individual assigned as the chief compliance
20 officer at the firm?

21 A Yes.

22 Q Would that -- let me rephrase the
23 question.

24 Who generally would file this document
25 with the SEC each year?

1 A It would have been Scott Roland until he
2 left his position, I believe, in December of 2017.

3 Q And then, who took over after that?

4 A Then it was Phoebe Venable.

5 Q And how long did Ms. Venable hold that
6 role as far as you recall?

7 A She's held it probably 'til 2019. And
8 we've now designated Ryan Hitt and we've hired an
9 outside compliance consultant to help us and
10 review it.

11 Q Who is the outside compliance consultant
12 that's been hired?

13 A Hold on, let me check.

14 Jon Hurd is his name. I think it's -- I
15 just don't remember the name of his firm.

16 Q And that's -- is it H-U-R-D?

17 A Yes. It's J-O-N, H-U-R-D. He did a
18 complete review of all of our documents when we
19 became part of Charles Schwab.

20 Q That would have been around the -- that
21 would have been around the 2018 to 2019 time
22 period that Mr. Hurd conducted that review?

23 A Yes.

24 Q Okay. So, going back to the version of
25 the brochure that I have displayed from February

1 of 2016. Were there any other outside compliance
2 consultants that you're aware of that worked on
3 this version of the firm brochure around 2016?

4 A Yes.

5 Q What consultant was that?

6 A The first name is Howard Landers and I
7 think it's BridgeHouse Consulting. I believe. I
8 don't remember the name of his company either, but
9 I think it was BridgeHouse.

10 Q Who would have been the person that at
11 CapWealth that would have most regularly
12 associated with Mr. Landers concerning his
13 consulting work on behalf of CapWealth?

14 A Scott Roland and Phoebe Venable.

15 Q Did you, yourself, regularly communicate
16 with Mr. Landers about compliance needs of the
17 firm?

18 A Yes, but in a limited way.

19 Q What ways do you recall interacting with
20 Mr. Landers concerning compliance needs at
21 CapWealth?

22 A Well, I specifically talked to him about
23 industry trends, where the industry was going, the
24 things that we needed to be aware of. You know, I
25 discussed, you know, my intent. At one point he

1 was trying to get me to buy a broker-dealer and --
2 and, you know, I said, I'm more inclined to shut
3 it down. And finally convinced him that the shut
4 down was appropriate. And -- and -- so, just --
5 just general things. Nothing specific like it
6 would have been with Scott Roland where you were,
7 you know, doing documents or Phoebe where they
8 were, you know, reviewing and signing off on
9 documents.

10 Q I'm going to advance -- I'm going to
11 zoom in and I'm going to advance to page seven of
12 this document. And at the top of page seven
13 you'll see this is the beginning of a section
14 called, Fees and Compensations. Can you see that,
15 Mr. Pagliara?

16 A Yes.

17 Q Okay. I'll zoom in a little bit more
18 too. Is that better?

19 A Yes.

20 Q Okay. I'm going to scroll down. So,
21 lower in the section on the next page at the
22 bottom of page eight. And do you see the very
23 last paragraph that starts at the beginning of
24 page eight and continues onto the top of page
25 nine? Can you see that okay?

1 A Yes.

2 Q Okay. I'm going to read that paragraph
3 for the record. It reads, quote, Most of the
4 investment professionals at CapWealth are also
5 registered with CWIS. It is not mandatory that
6 clients open an account with CWIS. Compensation
7 may be received by the principals at CapWealth
8 when certain portfolio transactions are effected
9 on behalf of investment advisory clients.
10 Therefore, the principals of CapWealth may receive
11 compensation as a result of acting in one or both
12 capacities, including the receipt of 12b-1
13 distribution payments from certain funds, end
14 quote.

15 Mr. Pagliara, are you familiar with this
16 paragraph that I just read?

17 A Yes.

18 Q Do you know how long it has been in the
19 CapWealth Part II A brochure?

20 A No.

21 Q Do you think it was in their prior to
22 2016, the version that we're looking at?

23 A I don't know.

24 Q Do you know who authored this section
25 that I just read into the record?

1 A No.

2 Q Did you, yourself, ever have any role in
3 editing or proposing revisions for this language
4 that I just read?

5 A No.

6 Q Do you have any understanding as to who
7 might have had a hand in drafting this in terms of
8 Scott Roland or anybody else?

9 A Yes.

10 Q What do you understand in terms of who
11 might have worked on this section?

12 A I think Phoebe Venable and Scott
13 probably had something to do with this section.
14 And it had to do with a general discussion about
15 how our business was evolving.

16 Q Do you know that for certain or is that
17 really speculation though?

18 A In context I think, you know, it's --
19 it's relatively certain, yes.

20 Q Okay.

21 A If you'll let me -- if you -- you know,
22 I'll -- I'll supplement that with, you know,
23 buying -- towards the end of CapWealth Investment
24 Services and as part of the evolution, the process
25 of the industry, we were dealing with -- you know,

1 we started dealing with clients that didn't
2 custody with us. That had custody arrangements at
3 Charles Schwab, narrowly, and maybe a couple of
4 other firms like Fidelity. And so, I think
5 that -- that's probably the genesis of where that
6 disclosure came from in that general discussion
7 of -- of how the industry was changing during that
8 period.

9 Q So, even in 2016 when this version was
10 created you think that you had clients that were
11 custodying their assets at Charles Schwab?

12 A Yes. We didn't -- we didn't start a
13 relationship or even open an account at Charles
14 Schwab, but they may have had a relationship --
15 they may have already been custodied at Charles
16 Schwab and they asked us to do advisory -- you
17 know, to take over advisory work for them. So,
18 that was starting, I believe, about in that
19 period.

20 Q Okay. In 2016 though, there were still
21 a good number of clients that were using CWIS as
22 their introducing broker-dealer for their
23 accounts, right?

24 A Yes.

25 Q And CWIS was using Sterne Agee as the

1 clearing broker-dealer for those accounts?

2 A Yes.

3 Q The section we were looking at at the
4 top of page nine reads, quote, The principals of
5 CapWealth may receive compensation as a result of
6 acting in one or both capacities, including the
7 receipt of 12b-1 distribution payments from
8 certain funds, end quote.

9 At this point in 2016 you were one of
10 the principals of CapWealth, correct?

11 A Yes.

12 Q And were you regularly receiving 12b-1
13 fees from clients investments in mutual funds that
14 were custodied through Sterne Agee at this time?

15 A The firm was. You know, I'm paid off
16 the profitability of the firm as a principal, but
17 yes, we -- we received them.

18 Q And as far as you know, did most 12b-1
19 fees -- did most clients who were invested in
20 12b-1 fees I should say, did they incur those
21 12b-1 fees on an ongoing basis such as monthly or
22 quarterly?

23 A You know, your question, you need to
24 reframe it. Clients don't invest in 12b-1 fees.

25 Q I'm sorry.

1 A I'm sorry, I didn't understand the
2 question.

3 Q Sure. Let me rephrase the question. I'm
4 sorry. There was a man weed whacking right
5 outside my window and it was throwing me off. I
6 apologize.

7 A No problem.

8 Q At this point in 2016 did you understand
9 that clients who were invested in mutual fund
10 share classes were incurring 12b-1 fees on a
11 recurring basis such as monthly or quarterly?

12 A Yes.

13 Q And is that your -- your understanding
14 today in terms of how mutual fund share classes
15 charged 12b-1 fees is that they typically recur on
16 a regular basis?

17 A Yes.

18 Q This language in Exhibit 6 says that the
19 principals of CapWealth may receive compensation
20 such as 12b-1 fees, but if you actually were
21 regularly receiving it why did it use the word
22 "may"?

23 A Because it was custodial dependent. If
24 the assets were custodied at BNY Mellon/Pershing
25 we didn't receive compensation. If they were

1 custodied at Charles Schwab we didn't receive
2 compensation. If they were custodied in an
3 account at Sterne Agee and they had an account at
4 Charles Schwab we would get a 12b-1 fee if it was
5 paid through our CapWealth Investment Services
6 relationship at Sterne Agee, but we wouldn't get
7 one at Charles Schwab. So, it was the only
8 accurate way that we could list that.

9 Q Well, for the -- could you have gone
10 back and listed out what you just said which is
11 that, for clients custodied at Sterne Agee we do
12 get 12b-1 fees if you have a mutual fund held
13 through Sterne Agee?

14 A Yes.

15 Q Do you know why that level of
16 specificity was not included in this version of
17 the brochure in 2016?

18 A Well, I think it would have one confused
19 the hell out of people and I don't think it was
20 necessary, you know. And we -- we could explained
21 that client by client based upon the relationship
22 that we had with the client.

23 Q Did you regularly --

24 A Pardon?

25 Q Did you explain that to clients

1 verbally?

2 A Absolutely. I discussed fees in
3 excruciating detail with clients. I used it as a
4 way to differentiate ourselves and the efficiency
5 that we have in our relationship with clients and
6 the compensation that we received from them.

7 Q Walk us through what you would have
8 regularly said to a client about 12b-1 fees in
9 2016 for clients who had their assets custodied at
10 Sterne Agee?

11 A You'd have to give me a more specific
12 example because I don't know -- you know, every
13 client's different.

14 Q So, if you had a client in 2016 around
15 the same time as this version of the brochure was
16 being used in February of 2016 whose assets were
17 custodied at Sterne Agee and they were going to be
18 invested or were already invested in mutual funds
19 that involved the charging of 12b-1 fees for the
20 share classes that they held, did you explain to
21 them the receipt of 12b-1 fees verbally and how it
22 flowed to you through your role as a registered
23 representative of CWIS or as an owner of CapWealth
24 Group or CapWealth Advisory, LLC?

25 A Yes.

1 Q Walk us through what you would have said
2 to a client who was in that type of a situation in
3 2016?

4 A I would have said, you know, we are, you
5 know, committed to providing you the lowest cost
6 that we can, you know. We will -- for example,
7 with that client relationship that I talked about,
8 if they opened a new trust account, I would have
9 said, Look, we're going to put you in a share
10 class where we'll get compensation at 25 basis
11 points. We're not going to charge you an
12 administrative fee. We're not going to charge you
13 an advisory fee. We'll do this as an accommodation
14 based upon the whole relationship that we have
15 with you. We would adjust our discounting policy
16 to the total relationship and -- and what we would
17 be paid.

18 So, it was part of a broad discussion
19 that we had with every client where we were trying
20 to price the relationship fairly and equitably
21 based upon everything that they had with us.

22 Q At this point in February of 2016, if
23 you were choosing a mutual fund investment for an
24 advisory client was it usually an American Funds
25 fund?

1 A It's hard to say, but I would generally
2 say yes. And again, I was doing less and less
3 work with mutual funds as time went on. You know,
4 most of our accounts are dominated by individual
5 security selection.

6 Q For -- for clients that you were making
7 or providing advice about mutual fund investments
8 in 2016, was American Funds -- were American Funds
9 funds often some of the funds you advised them to
10 purchase?

11 A Yes.

12 Q Okay. In discussing 12b-1 fees with
13 clients that might be generated by those types of
14 mutual fund investments in 2016, did you highlight
15 for them the different share classes, such as F1
16 and F2, in your discussions with clients, your
17 verbal discussions?

18 A Yes.

19 Q How would you do that?

20 A I'd just -- you know, we would -- it got
21 to the point where it was confusing because we had
22 F1 shares and F2 shares in the same account and
23 the same fund.

24 Q Walk us through what you had said to
25 clients about the differences between F1 and F2

1 shares at that time in 2016?

2 A That they created a lower share class
3 and it's our intention to -- we -- typically we --
4 that's -- we would purchase them and then it would
5 come up in the discussion as to why they've got F1
6 and they've got F2. And, you know, the discussion
7 centered around, you know, this is where the
8 industry is going and eventually we'll convert all
9 of these to a single share class.

10 Q Were there many clients that held both
11 F1 and F2 shares at the same time?

12 A I would say it was -- you know, it
13 was -- when we made additional purchases, yes, it
14 started to become -- started to become an issue.

15 Q And what do you mean by an issue?

16 A Well, we were trying to -- from 2015 on
17 we were trying to get our custody arrangements
18 moved from Sterne Agee to Pershing, you know, to
19 get a final home for all of our assets.

20 And so, you know, you had -- the whole
21 industry was exploding. You had F1 shares. You
22 had F2 shares. You had American Funds announcing
23 that they were creating F3 shares. You had this
24 problem with -- that existed with Charles Schwab
25 and all of the big firms. You know, we literally

1 had to force them into F3 shares.

2 So, even from the point that it was
3 announced that they were going to make those
4 available in 2016, we couldn't buy them. They
5 weren't available. And it was very expensive both
6 in terms of time and money for the client to -- to
7 make those conversions.

8 You understand how those conversion
9 process works, don't you? It's a very complicated
10 thing.

11 Q So, were these the type of things you
12 would have explained to clients in terms of
13 talking about the different share classes?

14 A Yeah. As they asked me, you know, why
15 have I got F1 and F2 shares? You know, and it
16 was -- it was a difficult situation for us too.

17 Q So, I don't see -- in this language
18 concerning 12b-1 fees in Exhibit 6 I don't see any
19 discussion about share class differences. Did you
20 ever consider having the firm add any language
21 about share class differences and how it would
22 impact 12b-1 fees to the firm's brochure?

23 A No.

24 Q And give us an explanation as to why
25 that was? Why not add that to the brochure?

1 A We didn't think it was necessary.

2 Q And we just want to -- I don't want to,
3 you know -- you know, we'll obviously go back and
4 we'll talk with other folks at the SEC about, you
5 know, testimony today and I don't want to put
6 words in your mouth. So, could you just walk us
7 through a little bit more why you didn't think
8 that level of disclosure in the brochure was
9 necessary?

10 A We were still operating under the
11 understanding about our disclosures in 2011 that
12 we had worked through the SEC with. This, you
13 know, page eight that you're talking about, was an
14 enhancement to reflect changes that were
15 occurring. We never had more than one custodian in
16 2011.

17 So, you know, don't let the good be the
18 enemy of the perfect. I mean, we could have taken
19 this document and, you know, thrown a lot of
20 things in there, you know, but you're trying to do
21 the best you can and communicate the best you can
22 with your clients. And that's what we were doing.
23 And that was the direction we were taking
24 everything in.

25 Q So, this section where it does describe

1 in Exhibit 6 on page eight and nine, the 12b-1
2 fees, I also don't see 12b-1 fees described as
3 conflicts of interest. Do you consider 12b-1 fees
4 to be a conflict of interest for CapWealth or its
5 registered representatives back when CWIS was in
6 existence?

7 A Conflicts of interest are inherent and
8 you minimize the inherent nature of a conflict of
9 interest through disclosure. And the disclosures
10 that we made go back to when we first set up the
11 firm. And the SEC examination of our firm that
12 took two weeks with eight examiners and we went
13 through all of this in detail, we were operating
14 under that.

15 The way we received 12b-1 fees because
16 of the disclosures we make, I don't think that was
17 a conflict of interest. I think we minimized that
18 through disclosure, but that's something that
19 exists every where. You have a conflict of
20 interest in this examination. Every time a
21 transaction is done at Charles Schwab when we buy
22 a bond they potentially -- there is a conflict of
23 interest. Did they get the best execution on that
24 bond.

25 If you're an adviser at UBS and you're

1 operating under an investment management agreement
2 and you execute a transaction through UBS's
3 brokerage division there's a conflict of interest.
4 So, this whole talk about conflict of interests,
5 you know, suggests that we were doing something
6 that wasn't in the best interest of our clients
7 and I object to that.

8 Q So, do you feel that any conflict of
9 interest that related to 12b-1 fees was cured in
10 some way through verbal disclosures that you made
11 to clients?

12 A Verbal and written.

13 Q And if you could walk us through -- I
14 think we've talked about the verbal. Which
15 written ones are you specifically referring to?

16 A The disclosures that existed in CWIS,
17 the disclosures that you're referencing here, ADV
18 Part II A, page eight and nine. It was just part
19 of our practice. Everybody knew that. It wasn't
20 anything that was hidden and it was very
21 proactively dealt with as we attempted to be a low
22 cost provider of advisory services to our clients.

23 Q So, I think -- why don't we take a break
24 at this point.

25 MR. BASINGER: Would folks like to take

1 a longer break for lunch now at this point for
2 about 30 minutes or so?

3 THE WITNESS: That would be great.

4 MR. BASINGER: So, why don't we start
5 back up in about 35 minutes at 12:45 if that works
6 for everybody.

7 Gino, does that work for you?

8 MR. BULSO: Yes, that works fine, Brian.

9 MR. BASINGER: Okay.

10 So, we are off the record at 12:09 p.m.

11 (Whereupon, at 12:09 p.m., a luncheon
12 recess was taken.)

13 A F T E R N O O N S E S S I O N

14 MR. BASINGER: We are back on the record
15 at 12:46 p.m. on Friday, May the 1st, 2020.

16 BY MR. BASINGER:

17 Q Mr. Pagliara, can you confirm that while
18 we were off the record that we did not continue
19 having substantive discussions of this matter?

20 A Yes.

21 Q Thank you.

22 So, before the break we were looking at
23 Exhibit No. 6 and specifically we were in the
24 section that runs pages seven through nine which
25 is the subsection -- and I'll scroll to the top of

1 page seven again -- called Fees and Compensation.
2 And what I wanted to do -- and we'll come back to
3 Exhibit 6, but I'm going to open another exhibit.

4 This is a new exhibit marked as CAP
5 Exhibit No. 23 which is the Form ADV Uniform
6 Application for Investment Adviser Registration.
7 And this provides the Part II uniform requirements
8 for the investment adviser brochure and brochure
9 supplement.

10 I'll scroll down to the bottom just to
11 note the exhibit stamp for Exhibit No. 23. And
12 then for the record, I'll note I just pulled this
13 from the SEC. This is not something that was
14 produced by CapWealth in this matter. This was
15 just an SEC document that's made available to
16 registrants that are completing their Form ADV
17 brochures.

18 This version is the version that was in
19 effect through February 28th of 2018 and was
20 subsequently replaced by a more recent version,
21 but this is the version that was in effect back in
22 early 2018 and in the months before that.

23 And what I was going to do was go to the
24 instructions for the Part II A brochure. They
25 begin on page three. And then specifically, since

1 we were looking at section five of the CapWealth
2 brochure I was going to go to the instructions for
3 section five which is the fees and compensation
4 section.

5 And I'll note -- draw your attention, I
6 should say, to item E, section 5E which reads,
7 quote, If you or any of your supervised persons
8 accepts compensation for the sale of securities or
9 other investment products, including asset-based
10 sales charges or service fees from the sale of
11 mutual funds, disclose this fact and respond to
12 Items 5.E.1, 5.E.2, 5.E.3 and 5.E.4, end quote.

13 And then, those sub parts 5.E.1 through
14 5.3.4 are listed below with the first one 5.E.1
15 reading, quote, Explain that this practice -- let
16 me start over.

17 Quote, Explain that this practice
18 presents a conflict of interest and give you or
19 your supervised person's an incentive to recommend
20 investment products based on the compensation
21 received rather than on a client's need. Describe
22 generally how you address conflicts that arise,
23 including your procedures for disclosing the
24 conflicts to clients. If you primarily recommend
25 mutual funds, disclose whether you will recommend,

1 quote, no load, unquote, fund, end quote.

2 So, I just want to start there with
3 these instructions about item 5.E.1. Mr.
4 Pagliara, we were looking earlier at the CapWealth
5 Exhibit No. 6 which was the Part II A brochure for
6 the firm from February of 2016. And while there
7 was some language there about the firm principals
8 may receive -- stating that the firm principals
9 may receive 12b-1 fees, as I noted before the
10 break, I didn't see language in that section about
11 12b-1 fees which are a type of service or
12 distribution fee representing a conflict of
13 interest or presenting a conflict of interest.

14 Were you -- were you aware of these
15 instructions that existed concerning what was
16 supposed to be in the Form ADV Part II A Brochure
17 for an advisory firm?

18 A These specific instructions --

19 Q Correct?

20 A -- as outlined by E.1?

21 Q Correct.

22 A Yes.

23 Q And so, if the instructions calls for
24 the firm to explain that the receipt of service
25 fees for the sale of mutual funds presents a

1 conflict of interests why was that not stated in
2 CapWealth's brochure as we saw in Exhibit 6?

3 A Because I don't think it was a conflict
4 of interest. Period.

5 Q So, that's your personal view that it
6 was not a conflict of interest?

7 A That's my view and it's the position of
8 my firm.

9 Q Do you disagree with the instructions
10 that -- that say to explain specifically that that
11 does present a conflict of interest?

12 A Yes.

13 Q Was it a conscious decision to not
14 follow instruction 5.E.1 when the CapWealth
15 brochure was drafted?

16 A No. If I didn't believe it was a
17 conflict of interest there was nothing to
18 disclose.

19 We've been through this, Mr. Basinger.
20 This goes all the way back to 2011, you know, when
21 we sat down and we explained our business, our
22 business model to the SEC during a two-week audit
23 with eight examiners present. Period.

24 There was no conflict of interest in the
25 process that we either selected mutual funds or

1 placed them in our clients accounts as we met
2 their investment objectives.

3 Q So, in the instruction for 5.E.1 do you
4 see there being latitude for you to decide
5 unilaterally that there is not a conflict of
6 interest related to service fees from the sale of
7 mutual funds?

8 A Would you repeat the question?

9 Q So, when I look at the instruction for
10 5.E.1 I don't see there being ability for an
11 investment adviser who's registered and completing
12 the Part II A Brochure to decide whether or not
13 service fees from the sale of mutual funds present
14 a conflict of interest. The way I read the
15 instructions is that the instructions say, If you
16 do receive service fees from the sale of mutual
17 funds you are supposed to, in your Part II A
18 Brochure, explain that this practice presents a
19 conflict of interest and then explain how you
20 address that conflict. Do you disagree with --

21 A You and I disagree on the interpretation
22 of that section, yes.

23 Q Okay, that's my question. I just wanted
24 to find out your reaction to reading the
25 instructions now that you have a chance to see

1 them here.

2 MR. BASINGER: I don't think I have any
3 questions on instructions 5.E.2, 3 or 4, but I'm
4 going to move down to give everyone a chance to
5 look at them.

6 Kristin, Steve, did you have any other
7 questions that you wanted to ask on this part
8 before I move on to another section.

9 MS. MURNAHAN: I do not.

10 MR. BASINGER: Okay.

11 Q I'm going to move on to the instruction
12 for item ten. So, I'm moving to page ten of
13 Exhibit 23 which is titled, Other Financial
14 Industry Activities and Affiliations. And I'm
15 going to draw your attention to item 10.C where
16 the instruction reads, quote, Describe any
17 relationship or arrangement that is material to
18 your advisory business or to your clients that you
19 or any of your management persons have with any
20 related person listed below. Identify the related
21 person and if the relationship or arrangement
22 creates a material conflict of interest with
23 clients, describe the nature of the conflict and
24 how you address it. End quote.

25 And then the list of related persons

1 below that include broker-dealer, municipal
2 securities dealer or government securities dealer
3 or broker-dealer, among other items that are
4 listed.

5 Now, as we saw earlier today in Exhibit
6 6, Mr. Pagliara, the brochure for CapWealth did
7 identify the relationship between CWIS and
8 CapWealth Advisors, correct?

9 A Yes.

10 Q But it did not identify any specific
11 material conflict of interest from that
12 relationship, correct?

13 A Yes.

14 Q So -- and again, is -- is that because
15 you did not believe there was a conflict of
16 interest to disclose?

17 A Yes.

18 Q Okay.

19 MR. BASINGER: Kristin, or, Steve, did
20 you have any other questions you wanted to ask on
21 this section?

22 MS. MURNAHAN: No, I do not.

23 MR. BASINGER: Okay. I'm going to close
24 Exhibit 23 and go back to Exhibit 6 and move on to
25 page 22.

1 Q At the top of page 22 of Exhibit No. 6
2 is a subsection called, Best Execution. And it
3 reads, quote, It is CapWealth's policy to obtain
4 the, quote, best execution, end quote, of its
5 customers securities transaction on a best efforts
6 basis since the firm does not control trade
7 execution. CapWealth, through the trading
8 department at SAL or any other custodian will
9 cause each customer's securities transaction to be
10 executed in such a manner that the customer's
11 total cost or proceeds in each transaction is the
12 most favorable under the circumstances. End
13 quote.

14 Mr. Pagliara, are you familiar with this
15 best execution language that I described?

16 A Yes.

17 Q What do you understand this to mean?

18 A Just exactly what it says.

19 Q And what does it mean in terms of how
20 you service a client in terms of a transaction?
21 Can you give us an example?

22 A I don't understand the question.

23 Q Okay. Let's go to the scenario where
24 you're making an advisement for a client and
25 you're advising them to invest in a specific

1 mutual fund. And let's -- you know, we'll go back
2 to what you were doing in, say, calendar year
3 2016. If a client qualified or was eligible to
4 buy the F1 share or F2 share of a mutual fund and
5 you were recommending the fund how would you go
6 about choosing a fund share class in light of this
7 best execution policy?

8 A That question doesn't even apply to
9 mutual funds. Best execution in this context has
10 to do with trade execution and it has to do with
11 pricing. Mutual funds are bought and sold on the
12 executed price of the day that they're purchased
13 or the day that they're sold. So, this doesn't
14 even apply to mutual funds.

15 Q So, is it your view that the mutual
16 funds if the share classes have a differentiation
17 in terms of the 12b-1 expense that does not impact
18 best execution?

19 A Mr. Basinger, this does not apply to
20 mutual funds. This best execution section does
21 not apply to mutual funds. It has to do with
22 individual security transactions of bonds and
23 stocks and trade execution. It's understood by
24 the plain meaning of that section that it does not
25 apply to mutual funds.

1 Q And I'm just asking for your
2 understanding. So, I just want to be clear. So,
3 you've made that clear. And my -- my only
4 follow-up question I have is, so you don't view
5 any type of mutual fund transaction, whether it
6 involves a 12b-1 fee or not, as being impacted by
7 the best execution policy?

8 A Not as it's contained in that section,
9 no.

10 Q Okay.

11 MR. BASINGER: Steve, or, Kristin, did
12 you have any other questions on that section?

13 MS. MURNAHAN: Not at the moment.

14 MR. BASINGER: Okay. I'm going to close
15 Exhibit No. 6 and move on to a new exhibit.

16 Q Now we are going to display what has
17 been marked as CAP Exhibit No. 22 which is a Form
18 ADV Part II B Brochure Supplement for Timothy J.
19 Pagliara. And I'll scroll down to show you the
20 whole front page with the exhibit stamp and the
21 Bates stamp of CW 000112 at the bottom.

22 MR. BASINGER: I'll note for the record,
23 the front page here does not show a date on the
24 document, but I will note that when this document
25 was produced to us the file extension showed that

1 the title of the document was dated February 8th,
2 2016. So, I just wanted to note that for the
3 record from February of 2016 according to the
4 document title, even though I'm not aware that
5 there's actually a date within the document
6 itself.

7 Q Mr. Pagliara, are you familiar with
8 Exhibit No. 22?

9 A In general.

10 Q And what do you understand this to be?

11 A Form ADV Part II B.

12 Q Is this a particular document that you
13 use in a certain way with your clients?

14 A It's part of the disclosure that we hand
15 every client, yes.

16 Q And so, a copy of this is provided to
17 each of your clients?

18 A Yes.

19 Q Who put this document together?

20 A Scott Roland, the compliance officer,
21 and possibly in consultation with our compliance
22 consultant.

23 Q Before this document was ever given to
24 clients did you have a role in reviewing and
25 approving it for final form?

1 A Yes.

2 Q And did you approve it before it was
3 finalized and given to the client?

4 A I believe so, yes.

5 Q Okay. I'm going to turn to, or advance
6 I should say, to page five of Exhibit No. 22 which
7 is a section called, Additional Compensation. And
8 that reads, quote, Neither CapWealth, nor Mr.
9 Pagliara, have any arrangements, oral or in
10 writing, where it: One, is paid cash by or
11 receives some economic benefit from a non client
12 in connection with giving advice to client; Two,
13 directly or indirectly compensates any person for
14 client referrals. End quote.

15 Mr. Pagliara, are you familiar with this
16 language on page five?

17 A Yes.

18 Q How does this relate to your receipt of
19 12b-1 fees that you received from 2018 and prior?

20 A It doesn't have anything to do with
21 12b-1 fees.

22 Q And why is that?

23 A Industry practice at the time and it has
24 since been kind of -- it was for CPAs and other
25 professionals and other individuals to solicit

1 cash payments and referral arrangements. We never
2 engaged in those and we made that statement that
3 we don't do that.

4 And that was actually a requirement and
5 a suggestion by the SEC with specific reference to
6 those referral arrangements between CPAs and other
7 professionals and we never engaged in that process
8 or that -- or that -- any type of arrangement like
9 that. That is what that disclosure is for.

10 Q So, it's your understanding this
11 language where it talks about an economic benefit
12 from a non client would not be meant to capture
13 12b-1 fees that you or CWIS received from a mutual
14 fund based on a client's mutual fund investment?

15 A It had absolutely nothing to do with
16 mutual funds or 12b-1 fees as I've previously
17 qualified my answer.

18 Q I'm going to go back one page in the
19 document to the Other Business Activities page.
20 And unfortunately, it's longer than I think I
21 could make it fit on the screen at one time, but
22 I'm just going to put up the top part of the page.
23 And if you want to take a look at it and let me
24 know when you're ready for me to advance to the
25 bottom of the page so I can give you a chance to

1 look at the whole section then I can proceed.

2 A You can go down. You can go lower.

3 (The witness examined the document.)

4 Q Let me know when you're ready for
5 questions.

6 A I'm ready for questions.

7 Q So, my questions really are on the
8 bottom part of the page where it talks about your
9 being an associated person of CWIS, the affiliated
10 broker-dealer of CapWealth. There's a section
11 here which describes effectively what is a
12 transaction charge that clients incur based on
13 certain transactions for their account, but I
14 don't see any language in here concerning 12b-1
15 fees or your receipt of them at this time period
16 in 2016 for clients who were having their assets
17 custodied at Sterne Agee. Do you know why there's
18 no disclosure in here about your receipt of 12b-1
19 fees?

20 A Because that's not the intention of this
21 section. If you'll go back to our 2011 audit and
22 the recommendation of the SEC, they -- for not
23 clarifying the relationship of that 14.95
24 transaction fee and the fact that there was a
25 difference between what Sterne Agee charged us and

1 what we ultimately collected. So, in response to
2 what they suggested, and it's in the audit, this
3 is how we updated that disclosure based upon their
4 recommendations.

5 Q Did CapWealth ever continue to consult
6 the instructions though for the Part II B
7 Supplements that were issued by the SEC?

8 A I don't understand the question.

9 Q So, you're talking about content -- I
10 understood your most recent response to be that
11 certain content about the transaction charges
12 added after an examination by the SEC in 2011,
13 correct?

14 A Yes.

15 Q And my question is, when this document
16 was updated or reviewed after 2011, did CapWealth
17 review the then operative instructions about Part
18 II B supplements to see if CapWealth was also
19 addressing everything else the instructions called
20 for?

21 A Yes.

22 Q And how do you know that? Were -- did
23 you have a role in that process?

24 A We would have discussed it in very
25 specific forms. Again, our disclosures did not

1 change substantially from 2011 following that
2 audit. So, there wouldn't have been a whole lot to
3 do with anything to update our disclosures or
4 update a discussion of our business policy or any
5 of the things that you keep hammering away at.

6 MR. BASINGER: Steve, or, Kristin, do
7 you have anything else that you want to ask about
8 on this document?

9 MS. MURNAHAN: No.

10 MR. BASINGER: Okay. I'm going to close
11 Exhibit 22 and I'm going to put up what was
12 previously marked as CAP Exhibit No. 8.

13 Q And this is an e-mail chain that
14 concludes on May 13 of 2015. My first question is
15 going to be, at the top of the page you'll see the
16 from field shows it's from Phoebe Venable at --
17 and her address is listed as PVenable
18 CapWealthAdvisors.com. And the recipient in the
19 to field is Tim Pagliara at TPagliara
20 CapitalWealthAdivsors.com.

21 Mr. Pagliara, is that your work e-mail
22 address?

23 A That's it.

24 Q Is there any other work e-mail address
25 that you currently use?

1 A No.

2 Q Okay. If we see an e-mail today that is
3 sent to that address or from that address could we
4 assume that it was you that was sending or
5 receiving it?

6 A Yes.

7 Q So, I'm going to scroll down to the
8 second page where the e-mail chain begins. And as
9 I scroll down I'm going to stop and note that the
10 Bates stamp on the first page is CW 001862. And
11 then you'll see on the second page the only
12 content that's on that page at all is, basically,
13 a -- some disclaimers that were at the bottom of
14 the signature block from the first page. So, I'm
15 going to go back up now to the first page where
16 the actual e-mail exchange occurs.

17 MR. BASINGER: So, I'll note for the
18 record that the subject line is Re, or R-E, colon,
19 Update on Mark, dot, dot, dot.

20 Q Mr. Pagliara, can you identify what's
21 going on in this e-mail chain in Exhibit No. 8?

22 A Yeah. No, I know exactly what's going
23 on in this e-mail chain. Mark Willoughby was an
24 adviser with us that we essentially parted ways
25 with early in 2014, but the process was underway

1 in 2000 -- early 2015 and the process was underway
2 to have him find a new home from the firm in 2014.

3 And so, when he left he only took the
4 accounts that he wanted and he left us with a
5 number of really small accounts that didn't fit
6 into the type of business that we were doing which
7 was really the basis of why he left in the first
8 place. And when I refer to the kids I'm talking
9 to my -- you know, I've got a group of millennials
10 that are really high energy, get good experience
11 in dealing with clients and I wanted them to, you
12 know, work with these people that were going to
13 stay or were on the fence or for whatever reason
14 hadn't moved their accounts. We had an obligation
15 to try and make sure that their objectives were
16 being met. And we had fundamentally disagreed
17 with how Mr. Willoughby was -- had his accounts
18 structured before he left.

19 Q Walk us through what were some of the
20 ways you disagreed with Mr. Willoughby's account
21 structuring.

22 A Reasonable minds differ, you know. He
23 thought the world was going to end for the
24 previous five years and, you know, he had in -- in
25 his interpretation of what his clients needs were

1 and his belief of the markets that, you know,
2 again, the world was going to end. So, he had a
3 lot of cash and a lot of gold in his accounts and
4 it didn't work well.

5 Q And I just want to make sure we
6 understand, when you say he thought the world
7 would end do you really mean he anticipated an
8 apocalypse or more of a market crash?

9 A Both.

10 Q Okay. Had Mr. Willoughby participated
11 before he left in migrating any of his clients
12 over to Pershing?

13 A No.

14 Q So, for the clients that were left
15 behind that stayed with CapWealth, did any of them
16 move over to Pershing or were they all kept with
17 Sterne Agee for the custody of their assets?

18 A They would have stayed at Sterne Agee.
19 You know, we went through this process of even
20 trying to get his clients to respond to this. We
21 didn't know if he was sending them transfer
22 instructions. It was a very difficult -- very
23 difficult because we couldn't just -- I would have
24 gladly just transferred those accounts over to
25 Hilliard Lyons where he ended up, but I couldn't

1 do that under the rules. We had to get them, you
2 know, manually to agree.

3 Q So, Ms. Venable in the first e-mail in
4 the chain wrote that she had calculated a net loss
5 revenue from Mr. Willoughby's departure of
6 \$118,500.00.

7 A 181,000. It was 181,000.

8 Q Well, if you look there at the line
9 above that initially it says, A net loss of
10 revenue of 118,500. And then the next line it
11 says, I calculated 181,500.

12 A Yes.

13 Q So, it was one of the two numbers
14 obviously. My question though is really about
15 your reply regardless of the amount. You write
16 back in the e-mail above writing, quote, I doubt
17 that it would be that much of a loss. Remember
18 his revenue was rapidly trailing down. Put the
19 kids on getting his people in and restructuring
20 the accounts to our mutual fund model, et cetera,
21 end quote.

22 I just wanted to ask, what did you mean
23 about having the kids restructure the account to
24 the mutual fund model? What was that a reference
25 to?

1 A His revenue was rapidly trailing down
2 because people were tired of his advice. His
3 advice wasn't working. The apocalypse never
4 occurred and the meltdown never occurred. And,
5 you know, we needed to address that head on with
6 his clients. I actually dealt with some of those
7 clients individually myself, you know. And if he
8 hadn't left they were going to leave anyway. So,
9 the people that stayed, you know, by enlarge were
10 very, very frustrated with his advice, the advice
11 that he had given.

12 Q What's the mutual fund model that you
13 refer to in your e-mail?

14 A We had put together a mutual fund model
15 in -- to handle really small accounts. Remember,
16 mutual funds were a small percentage of our
17 business and we deal primarily with individual
18 portfolios, individual -- that are constructed
19 with individual companies. So, a lot of Mr.
20 Willoughby's accounts were 50,000, 100,000,
21 \$200,000.00. And they didn't reflect -- we needed
22 to get in, determine what their investment
23 objectives were, and then, you know, do our best
24 to try and get them on a better path. And our
25 mutual fund models seemed to be the -- the most

1 efficient way of doing that if we couldn't do it
2 with individual stocks.

3 Q What do you -- well, what was the
4 difference between the mutual funds that Mr.
5 Willoughby had been using versus what was at that
6 time listed on the mutual fund model? Were they
7 different funds or different share classes?

8 A No. No. It was just primarily a gold
9 fund that he had. I don't remember specifically.
10 And it was just -- it was not the way I would have
11 structured an account given the objectives that a
12 client had. But, you know, we were also during a
13 period where he could have been right, the world
14 could have ended, you know. And I didn't impose,
15 you know, my beliefs on him, but at the time that
16 it didn't make sense for him to be losing as much
17 business as he was, it made sense for him to leave
18 which.

19 Q When Mr. Willoughby did choose
20 investment funds -- or let me rephrase.

21 When Mr. Willoughby did choose mutual
22 fund investments for his clients, did he tend to
23 also choose 12b-1 fee paying share classes for his
24 clients?

25 A I don't know.

1 Q Do you know if there was an increase --
2 in the clients that were left behind was there an
3 increase in those that were invested in 12b-1 fee
4 charging share classes once they were converted
5 over to the mutual fund model that you referenced?

6 A I wouldn't know.

7 Q Okay.

8 MR. BASINGER: Steve, or, Kristin, do
9 you have any questions on this document before I
10 move on?

11 MS. MURNAHAN: I do not.

12 MR. BASINGER: Okay. So, I am closing
13 Exhibit 8 and I'm going to now open Exhibit No.
14 13. Give me one second to get that opened up.

15 And this is also an e-mail chain. This
16 one concludes on March 15, 2018. And the Bates
17 stamp on the first page is CW 001755. And I'll
18 search here the -- there's only a handful of words
19 that go over on the second page.

20 Q The first e-mail in the chain is from
21 you, Mr. Pagliara, on March 14, 2018 writing,
22 quote, We need to make sure share classes convert
23 immediately upon receipt by Schwab. Lowest share
24 class cost available, end quote.

25 Do you recall sending this e-mail on

1 March 14, 2018?

2 A Yes.

3 Q What do you recall about why you -- what
4 do you recall about why you sent this message?

5 A Because there had been an intention to
6 convert all of our shares to F3 series from
7 American Funds. From the point in time where
8 American Funds started talking about the
9 availability of those funds through their
10 wholesaling network in 2015 it -- it just -- there
11 was also the fiduciary rule that was getting ready
12 to be voted on and -- and adopted by the
13 Department of Labor. There was -- there were a
14 lot of things swirling during that time period.
15 And we had had the aborted, you know, move to
16 Pershing. You know, we went to move from Pershing
17 to Schwab and from Sterne Agee to Schwab,
18 basically, at the same time we were covered up
19 with administrative details. And when we arrived
20 at Charles Schwab, even those F3 shares existed,
21 none of the custodial firms were making them
22 available and we headed into a very, very
23 contentious round of discussions with Charles
24 Schwab and we said, Look, that's why we're here.
25 We want that fund.

1 And, you know, that's why my
2 instructions to the firm were, Get this done
3 immediately upon receipt by Schwab. And you've
4 got enough of the correspondence to know how
5 difficult that was and what an undertaking it is
6 to do a tax free exchange of thousands -- hundreds
7 of thousands of lines of dividend reinvestment and
8 different shares by different funds and going from
9 F1 to F3 and F2 to F3. And -- and that's what we
10 did, you know. And we were doing this as fast as
11 we could get it done at the same time that we were
12 implementing a new fee schedule to off set what we
13 were going to lose in the conversion.

14 Q So, I feel like -- I want to make sure I
15 heard you correctly. When the conversion to
16 Schwab was taking place there were still some of
17 the clients that had been migrated to Pershing in
18 2015 who were still at Pershing?

19 A Yeah. We went from Pershing to Schwab
20 and we went from Sterne Agee to Schwab. So, we
21 were -- we were executing a movement from two
22 different custodians at the same time account by
23 account, at the time almost \$800 million, and
24 every account had to be -- every account had to go
25 through that account transfer process. Even those

1 20 some odd kids accounts that, you know, I
2 referenced earlier as an example that we had.
3 So --

4 Q Let me -- let me jump in real quick. I
5 may have misspoken. Let me rephrase the question.
6 What I was trying to understand was,
7 when clients were migrated to Pershing in 2015,
8 did they stay at Pershing until they were moved to
9 Charles Schwab?

10 A Yes.

11 Q Okay. I may have just used the wrong
12 term in my prior question and misstated something.
13 So, thank you, that's all I wanted to clarify. I
14 just wanted to make sure none of the Pershing
15 clients ever moved back to Sterne Agee or to INTL
16 FCStone at some point?

17 A No.

18 Q Okay. So, going up to the next e-mail
19 in the chain, Ms. Venable writes back to you,
20 quote, Tim, Schwab will do the share class
21 conversion upon instruction as opposed to receipt.
22 To keep things clean, our plan was to convert
23 everything at quarter end, but we could go ahead
24 and initiate the first rounds now. Assets have
25 been cornered into Schwab the last two weeks.

1 Each mutual fund family has specific days for
2 share class conversion. It won't all happen at
3 once when we pull the trigger, but within two
4 weeks we should be 95 percent complete, end quote.

5 Do you recall, Mr. Pagliara, is what Ms.
6 Venable described in her e-mail what actually
7 happened in terms of things being 95 percent
8 complete in two weeks?

9 A No, because the operational difficulties
10 identified by the coordination that had to occur
11 both with -- between the mutual fund company,
12 between us and the operations department at
13 Charles Schwab.

14 Q And when would you say that that overall
15 conversion process was effectively completed for
16 most CapWealth clients?

17 A By September of 2019. It was -- I would
18 say call that the 100 percent complete date.

19 Q So, that was about 18 months after this
20 e-mail?

21 A Yes.

22 Q Okay. I'm going to go up in the e-mail
23 chain to the next e-mail that you sent to Ms.
24 Venable. And this time it does show more --
25 sometimes an e-mail chain, you know, doesn't

1 always show all of the other meta data like BC
2 recipients until you get to the top of the chain.

3 A Yes.

4 Q So, now it is showing -- this -- this
5 e-mail at least there was some people CC'ed on the
6 e-mail such as Ryan Hitt, Traci Olive. And in
7 this you write back to Ms. Venable, quote, Phoebe,
8 my inquiry was motivated by horror stories I have
9 heard about the SEC doing clawbacks over share
10 cost differences at this conference. I believe we
11 are differentiated, but I expect the SEC will be
12 here this year. I want it closed down and in the
13 rear view mirror, end quote.

14 What conference were you at?

15 A I think it was a Baron's conference.

16 Q And what is a Baron's conference?

17 A Baron's brings together industry experts
18 in a wide variety of fields. It's, you know,
19 engaged in best practices, everything from
20 different practice management techniques to the
21 different types of alternative investments,
22 private equity and -- and a lot of it's compliance
23 too.

24 Q What did you mean by the term horror
25 stories that you heard?

1 A Well, I -- exactly what I'm experiencing
2 right now, you know.

3 Q Well, let me -- let me rephrase the
4 question.

5 Was -- was this something that someone
6 mentioned to you in an off-the-cuff kind of
7 conversation or were you talking about hearing
8 something about the SEC as part of a presentation
9 at the conference?

10 A It was a presentation at the conference.

11 Q What do you recall about the
12 presentation?

13 A That you guys are hammering everything
14 that looks like a nail. And that you were heavy
15 handed, unreasonable. You were forcing these
16 firms to settle because they didn't want to
17 litigate. And when I said, we're differentiated,
18 we absolutely were differentiated.

19 Q And what did you mean by --

20 A Our practices were sound.

21 Q So, if you could just walk us through,
22 what did you mean by the term differentiated?

23 A Everything that we've talked about. We
24 had done full disclosure. We had consulted with
25 you in 2011. We were already moving towards a

1 pure RIA model. We were -- we had already shut
2 down our broker-dealer. We were consolidating to
3 Charles Schwab. We had reduced our costs to
4 virtually zero in terms of transaction fees. You
5 know, we -- we're one of the good guys. You know,
6 we have consistently reduced costs for our clients
7 and -- but I wanted it cleaned up. I wanted to
8 have it so that when you guys got in here you
9 could see that from 2014 on we had been
10 consistently attempting to stay ahead of trends in
11 the industry and reduce costs for our clients.
12 And be fair and equitable in how we do it and
13 meeting our fiduciary responsibility. But, yeah,
14 there were a lot of horror stories about how you
15 treated people.

16 Q And so when you say differentiated, were
17 you also comparing yourself to a specific other
18 type of firm? I just want to make sure,
19 differentiated from what?

20 A I could use Raymond James as an example.

21 Q How so?

22 A And I've sold many times against Raymond
23 James.

24 Raymond James, not only did they not
25 allow their advisors to keep 12b-1 fees, they kept

1 them in house in the firm. They never made it
2 part of the process. You know, the administrative
3 fee that you haven't asked about yet, Raymond
4 James expressed that as a percentage of assets.

5 There were clients that had \$10 million
6 accounts that were paying \$10,000.00 a year for
7 less administrative reporting than I was charging
8 clients \$200.00 that we subsequently increased to
9 \$300.00 at that point in time. You better believe
10 me we differentiated.

11 We were not settling mutual funds. We
12 were not doing commission products at the same
13 time that we had advisory accounts. We had
14 stopped all of that and we were going to a pure,
15 conflict free fiduciary model. That had been our
16 intent since 2014 as expressed by the news we made
17 in 2015 to the present.

18 Q But that process in terms of the
19 conversion wasn't completed, as you said, until
20 September of 2019 when the F3 share class
21 conversions were completed, correct?

22 A That's correct.

23 Q But we're just trying to understand a
24 little bit more about the other alternative paths
25 that might have been available in the past. So,

1 if you go back to say 2016, 2015, for the clients
2 that were still at -- whose assets were still at
3 Sterne Agee at that time, even after the Stifel,
4 or Stifel, however you pronounce it, acquisition
5 had concluded was there not a point in 2016 or
6 2017 where things had settled down and conversions
7 to F2 share classes without 12b-1 fees could have
8 been done for those assets at that time.

9 A You are not listening to me, Mr.
10 Basinger. I've answered that question. And just
11 because you keep asking it doesn't mean the
12 answers going to change. Nothing was being done
13 at Sterne Agee. They were cutting services. They
14 were planning for the shut down or sale of that
15 broker-dealer.

16 The conversion of a share class from F1
17 to F2 is a complicated thing that requires IT
18 time, it requires collaboration from the mutual
19 fund company. And during that period, the F3
20 shares were on the horizon. So, that would have
21 required us to get their cooperation to do three
22 conversions.

23 We were more concerned about getting out
24 of Sterne Agee without having to do deal with the
25 embarrassment of a firm that could have been put

1 in receivership. Thankfully, they weren't. And
2 Stifel Nicolaus gave them to International -- IC
3 International FCStone that didn't have a clue and
4 the service model got nothing but worse. It was
5 impossible to get that done at Sterne Agee during
6 that period of time.

7 Does that answer and put that to rest?

8 Q So, Mr. Pagliara, I'm just trying to
9 understand what your recollection was. So, I hear
10 your answer and I just wanted to circle back and
11 see how that compared to the experience in terms
12 of the F3 conversion that happened with Charles
13 Schwab. Just trying to clarify.

14 A The F3 conversion was simply we had to
15 force the issue on -- with Charles Schwab when
16 they realized that they were going to be giving up
17 hundreds of millions of dollars in 12b-1 fees on
18 those F2 and F1 shares they panicked. And they
19 wanted to put the cost of all of that on us. And
20 so, we had to just make it real, real clear to
21 them. And they eventually said, Yep, you're right.
22 And -- and they did what we instructed them to do,
23 but that wasn't an easy thing either.

24 Q Understood. So --

25 A You asked me -- and I'll just finish

1 with this. You asked me to differentiate my
2 position versus my understanding of another firm.
3 Raymond James, because they are their own
4 custodian and they are their own RIA and they have
5 their own broker-dealer, the differentiating
6 factors Raymond James has control over that. I
7 did not. I am a fly in ointment compared to the
8 rest of these other firms that you've
9 investigated. We don't have the plow at the time
10 that we did as an \$800 million firm. We were
11 dependent on what we could get accomplished
12 through the custodians that we worked with.
13 That's all, go ahead.

14 Q Where was the Baron's conference taking
15 place at that you were attending?

16 A There's some of them in -- outside of
17 Orlando at a Ritz-Carlton there and they held them
18 in Las Vegas. I don't remember where it was in
19 that particular year, but it's in both --

20 Q Okay.

21 A Both places.

22 Q So, in 2018, about four weeks before you
23 sent this e-mail that we see in Exhibit 13, did
24 you recall hearing about the SEC announcing its
25 share class selection disclosure self-reporting

1 initiative for investment advisors?

2 A I don't remember.

3 Q Have you ever heard --

4 A I have heard of it, yes.

5 Q What do you understand that initiative
6 to be?

7 A I understood that initiative as, if you
8 did something wrong you had an opportunity to
9 throw yourself under the bus so that you would
10 avoid maximum penalties and any other things. It
11 didn't apply to us. We were differentiated. We
12 had no reason to throw ourselves under your bus.

13 MR. BASINGER: I'm going to close
14 Exhibit 13 and open a new exhibit which is Exhibit
15 24. And CAP Exhibit 24 is a press release from
16 the SEC. And the date of the release is February
17 12, 2018. And the title of the press release is,
18 quote, SEC Launches Share Class Selection
19 Disclosure Initiative to Encourage Self-Reporting
20 and The Prompt Return of Funds to Investors, end
21 quote.

22 Q So, Mr. Pagliara, do you recall if you
23 saw the announcement of the initiative from the
24 SEC in terms of the written announcement with the
25 details such as I'm presenting here in Exhibit 24?

1 A I don't recall, no.

2 Q Do you recall how you became aware of
3 the initiative in terms of how you first came to
4 learn about its existence?

5 A It was brought front and center to us in
6 our -- in our field audit back in the fall of '19.

7 Q Okay.

8 MR. BASINGER: So, I'll note for the
9 record that the initiative was announced in
10 February of '18 and self-reporting was required to
11 have been concluded by the summer of 2018.

12 Q So, are you saying you didn't hear about
13 the initiative until some point in 2019?

14 A No. I knew about this when it was going
15 around the industry. I violated no federal
16 securities laws. There was nothing for me to do.
17 This release, if I had it pasted to your forehead
18 would have meant nothing because we had nothing to
19 report and we did nothing wrong.

20 Q So, Mr. Pagliara, I'm just trying to
21 understand whether the firm considered
22 self-reporting and what the process was. So, I'm
23 going to ask a couple of more questions.

24 A We never considered self-reporting.

25 Q Why is that?

1 A Because we did nothing wrong and we
2 violated no federal securities laws.

3 Q So, I'm not -- let me make a few
4 statements here. One, I'm going to ask a few more
5 questions. I want to make clear, I'm not asking
6 for any attorney-client privileged information.
7 Does that make sense?

8 A Sure. Yes.

9 Q Okay. In terms of CapWealth's decision
10 not to self-report as part of the SEC's initiative
11 in 2018, did it review the announcement of the
12 initiative to see if it was eligible to
13 self-report?

14 A No.

15 Q Okay. Did you talk with anybody at all
16 to consider self-reporting within CapWealth such
17 as the chief compliance officer?

18 A No.

19 Q I don't want to hear from you anything
20 about any attorney-client privileged information,
21 but I believe you mentioned earlier today you've
22 had some compliance consultants that have worked
23 with CapWealth, correct?

24 A Yes.

25 Q Did any of them provide legal advice at

1 all?

2 A No.

3 Q And is that spelled out in their
4 contract that they do not provide legal advice?

5 A Yes.

6 Q Did you consult with any of your
7 compliance consultants -- your external compliance
8 consultants about whether to self-report to the
9 SEC's initiative in 2018?

10 A No.

11 MR. BASINGER: Kristin, Steve, I don't
12 have anymore questions on Exhibit 24. Do you have
13 any questions you would like to ask?

14 MS. MURNAHAN: I do not.

15 MR. DONAHUE: I do not.

16 Q Mr. Pagliara, earlier today we had been
17 looking at some of the documents such as the
18 investment management agreement that we saw and it
19 noted that there was a administrative fee that was
20 incurred by some accounts. And I think you
21 mentioned that sometimes for such as the smaller
22 accounts you described you may not always charge
23 that administrative fee for an account. Could you
24 just walk us through that administrative fee and
25 what it is and when it was applied to accounts and

1 why.

2 A One of the unique characteristics of our
3 business model is that we do time weighted
4 performance reporting for our clients. They are
5 part of a database of assets. We take fees from
6 our custodians and then replicate the performance
7 of their account based upon the amount of money
8 they put into the account, the amount of money
9 that they take out of the account. Then on a cost
10 adjusted basis we report to them what their return
11 is then we compare it to various different
12 indexes. It's a -- it's an amazing system.

13 So, if you were a client of mine in
14 2001, I can tell you exactly what the return has
15 been on your account adjusted for the money that
16 you put in, the money that you took out adjusted
17 for all fees and how it compares to other indexes.
18 We provide that service because we think it's
19 important as part of the transparency that we
20 engage in in letting people know that they're
21 meeting their objectives.

22 And so, that has a cost attached to it.
23 The software itself costs a littler over
24 \$250,000.00 a year. There's specific hardware we
25 have to have in place in order to deliver that

1 service. We reflect that administrative fee as
2 best we can to the costs of that hardware as
3 differentiated from Raymond James and the other
4 firms that charge that fee as a percentage of
5 assets as an administrative cost.

6 So, that is what it's -- does that
7 answer your question?

8 Q It does. That -- that gives a helpful
9 context.

10 You mentioned that sometimes for a
11 smaller account you may not impose that
12 administrative fee, correct?

13 A That's correct.

14 Q Is it accurate that most of your clients
15 do pay that fee though?

16 A Yes.

17 Q And that fee was increased from 200 to
18 \$300.00 in 2018, correct?

19 A Yes.

20 Q Walk us through the background in terms
21 of the decision to increase the fee to \$300.00.

22 A We just looked at the cost of the
23 software, the cost of maintaining the program, all
24 of the costs associated with it. We hadn't
25 increased the fee in -- I don't think we increased

1 it since 2011. And everything else related to
2 those costs had gone up. In addition to the other
3 costs that we had in delivering that service, we
4 also brought in an outside consultant by the name
5 of Asland Partners and Asland Partners did a lot
6 of our process. They do an audit of our process
7 every quarter to make sure we are GISR compliant
8 which stands for Global Investment Standard
9 Reporting.

10 So, it's a very extensive part of our
11 process and it's -- it's part of our obligation,
12 we believe, to disclose.

13 Q Now, do you recall during the 2019 SEC
14 exam program visit to your office they pointed
15 during the period there was no reference to the
16 administrative fee in the firm's advisory
17 management agreement or the firm's brochure?

18 A Yes.

19 Q And do you recall that the fee was then
20 added to the advisory agreement and the brochure
21 after that?

22 A Yes. We corrected that oversight
23 immediately.

24 Q In the interim, between January of 2018
25 when the \$300.00 fee amount became effective and

1 that amendment to the document in September of
2 2019, did you verbally inform clients that there
3 was a \$300.00 administrative fee when new clients
4 were on boarded at CapWealth?

5 A Yes.

6 Q Walk us through what you told new
7 clients in that time period when the dollar amount
8 was not reflected in the advisory agreement or the
9 firm brochure?

10 A As part of our process in explaining the
11 costs that a client would incur in doing business
12 with us, you know, it was the advisory fee and it
13 was the administrative fee. By that point in
14 time, as we had no longer had a broker-dealer and
15 we were working on a pure RIA platform at Charles
16 Schwab, we were receiving no other compensation
17 from their account other than what we charged them
18 in the advisory and the administrative fee.

19 We -- we did it as kind of a badge of
20 honor. We also negotiated zero commissions. So,
21 we -- we cut their commissions from what they were
22 paying at Sterne Agee at 14.95 to zero. Which
23 again, we were very proud of. Other than, you
24 know, we had to implement a mutual -- there's a
25 transaction fee for mutual funds now because

1 Charles Schwab doesn't get anything related to
2 12b-1 fees since we had converted everything to F3
3 shares.

4 Q So, from that -- during that time period
5 of January 2018 to September of 2019, were there
6 other materials -- written materials that were
7 given to new clients that did spell out the
8 \$300.00 administrative fee?

9 A Yes. It was in all of our marketing
10 material that we handed to a client in addition to
11 the discussions we had with them.

12 Q Did clients receive those types of
13 documents either through e-mail or in paper?

14 A They'd receive them in paper.

15 Q And did you review that administrative
16 fee with clients in person ever?

17 A Always.

18 MR. BASINGER: Why don't we take a --
19 let's take a 15-minute break at this point, or 14
20 minutes, until 1:55 p.m. and then I think we can
21 come back and wrap up.

22 So, we are off the record at 1:41 p.m.

23 (A brief recess was taken.)

24 MR. BASINGER: So, we're back on the
25 record at 1:55 p.m. on Friday, May the 1st, 2020.

1 BY MR. BASINGER:

2 Q Mr. Pagliara, can you please confirm
3 while we were off the record we did not continue
4 having substantive discussions of this matter.

5 A Yes.

6 Q Thank you.

7 I just wanted to touch real quickly on
8 the concept of any annual compliance training that
9 takes place at CapWealth. Could you speak to that
10 and whether there is any type of annual compliance
11 education or training that occurs at the firm.

12 A Yes. We have an annual compliance
13 meeting and then we use outside sources to provide
14 modules of training that everybody participates
15 in.

16 Q So, let's just talk about each of those
17 real quick. Tell us about the annual meeting and
18 what takes place there for that annual compliance
19 meeting.

20 A The annual compliance meeting summarizes
21 the material that was covered in those on line
22 modules that, you know, we all have to incorporate
23 and take.

24 Q Is the annual meeting lead by somebody?
25 Is there an instructor or a person that leads the

1 annual meeting?

2 A The head of the compliance department.
3 Everybody has to participate. It's one of those
4 things where we require everybody to be present.

5 Q Does any external person come in as part
6 of the annual meetings and provide any information
7 or education?

8 A Not generally. I can't say it didn't
9 happen since 2009, but I don't believe so.

10 Q So, is it typically the chief compliance
11 officer that leads the annual compliance meeting?

12 A Yes.

13 Q Then, approximately how many on line
14 modules per year do individuals at CapWealth have
15 to complete as part of the compliance training?

16 A I don't know. It's part of a package
17 that's satisfies our compliance requirements in
18 continuing education.

19 Q Can you speak to whether it's one versus
20 more than one module throughout the course of the
21 year?

22 A It's actually a -- a long series of
23 things. You don't have to complete it all at one
24 time. So, it's -- it's one long module.

25 Q Okay. Mr. Pagliara, we have no further

1 questions at this time. We may, however, call you
2 again to testify in this investigation. Should
3 that be necessary, we will reach out to Mr. Bulso
4 first to let him know.

5 Mr. Pagliara, do you wish to make any
6 clarifying statements to the statements you've
7 already made today?

8 A No.

9 MR. BASINGER: Mr. Bulso, do you want to
10 ask any clarifying statements -- or, I'm sorry, do
11 you want to ask any clarifying questions of the
12 witness?

13 MR. BULSO: No, Brian, I've got no
14 questions.

15 MR. BASINGER: Okay. We are off the
16 record at 1:58 p.m.

17 (Whereupon, at 1:58 p.m., the
18 examination was concluded.)

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PROOFREADER'S CERTIFICATE

In The Matter of: CAPWEALTH ADVISORS, LLC

Witness: Timothy Pagliara

File Number: A-03907-A

Date: Friday, May 1, 2020

Location: Atlanta, GA

This is to certify that I, Maria E. Paulsen,
(the undersigned), do hereby certify that the
foregoing transcript is a complete, true and accurate
transcription of all matters contained on the recorded
proceedings of the investigative testimony.

(Proofreader's Name)

(Date)

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I, SHAUNNA H. MORAN, a Certified Shorthand Reporter and Registered Professional Reporter in the States of New Jersey, New York and The District of Columbia, and Notary Public of the State of New Jersey, do hereby certify that the foregoing is a true and accurate transcript of the testimony as taken stenographically by and before me at the time, place and on the date hereinbefore set forth.

I DO FURTHER CERTIFY that I am neither a relative nor employee nor attorney nor counsel of any of the parties to this action, and that I am neither a relative nor employee of such attorney or counsel, and that I am not financially interested in the action.

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